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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

2010 JAN 25 P 3:45

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
UNS ELECTRIC, INC. FOR THE
ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES
DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF
THE PROPERTIES OF UNS ELECTRIC, INC.
DEVOTED TO ITS OPERATIONS
THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. E-04204A-09-0206

NOTICE OF FILING

UNS Electric, Inc., through undersigned counsel, hereby files the Rejoinder Testimony of
Michael J. DeConcini, Thomas A. McKenna, Kentton C. Grant, Martha B. Pritz, Dallas J. Dukes
and D. Bentley Erdwurm in the above-captioned docket.

RESPECTFULLY SUBMITTED this 25th day of January 2010.

UNS Electric, Inc.

Arizona Corporation Commission

DOCKETED

JAN 25 2010

DOCKETED BY

By

Michael W. Patten
Jason D. Gellman
ROSHKA DEWULF & PATTEN, PLC.
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

and

Philip J. Dion
UniSource Energy Services
One South Church Avenue
Tucson, Arizona 85702

Attorneys for UNS Electric, Inc.

1 Original and thirteen copies of the foregoing
2 filed this 25th day of January 2010, with:

3 Docket Control
4 Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

5 Copy of the foregoing hand-delivered/mailed
6 this 25th day of January 2010, to:


7 Daniel Pozefsky
8 Residential Utilities Consumer Office
1110 West Washington, Suite 200
Phoenix, Arizona 85007

9 Timothy M. Hogan
10 Arizona Center for Law in the Public Interest
202 East McDowell Road, Suite 153
Phoenix, Arizona 85004

11 Jane Rodda, Esq.
12 Administrative Law Judge
Hearing Division
13 Arizona Corporation Commission
400 West Congress
14 Tucson, Arizona 85701

15 Maureen A. Scott, Esq.
16 Wesley Van Cleve, Esq.
Legal Division
17 Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

18 Steve Olea
19 Director, Utilities Division
20 Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

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Michael J. DeConcini

UNS Electric, Inc.

January 25, 2010

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1 **Q. Please state your name and business address.**

2 A. My name is Michael J. DeConcini. My business address is One South Church Avenue,
3 Tucson, Arizona 85701.

4
5 **Q. Have you reviewed the Surrebuttal Testimony filed by the Commission Staff, RUCO
6 and ASBA/AASBO and other parties (collectively, "other parties") to this rate case?**

7 A. Yes I have.

8
9 **Q. What is the purpose of your Rejoinder Testimony in this proceeding?**

10 A. The purpose of my Rejoinder Testimony is to address: (i) a summary of the benefits of
11 our proposal regarding the Black Mountain Generating Station ("BMGS"); (ii) the
12 Company's request to include certain non-revenue-producing post-test-year plant in rate
13 base; (iii) fuel and purchased power brokers fees and polices; and (iv) the
14 recommendations by ASBA/AASBO regarding school-specific renewable energy
15 programs, energy efficiency programs and time-of-use rates.

16
17 **I. BLACK MOUNTAIN GENERATING STATION.**

18
19 **Q. Dr. Fish states on page 2 of his Surrebuttal Testimony that "Staff does not accept
20 that BMGS should be included in rate base before all facts regarding the purchase
21 are known." How do you respond?**

22 A. All the facts about BMGS are known. The cost of the facility is known and amply
23 demonstrated through the Company's Direct and Rebuttal testimonies. The benefits of
24 UNS Electric owning BMGS are also known and well-documented throughout this case
25 and UNS Electric's last rate case. Those facts are not disputed. Further, the plant is in
26 operation and is serving customers through a 5-year tolling agreement at present. There
27 has been extensive discovery in this case where all parties have had considerable

1 opportunity to request information, go on-site and tour the facility and ask any questions
2 they had. Dr. Fish fails to provide any indication of what facts are not known about
3 BMGS.

4
5 **Q. Can UNS Electric afford to purchase this plant absent the rate relief that the**
6 **Company requests in this case?**

7 A. No. As Company witness Kentton C. Grant has stated multiple times, the *authority* to
8 acquire BMGS is different than the *capability* to acquire BMGS. Further, as Mr. Grant
9 states in his Rejoinder Testimony at page 2, the total cash that goes out from UNS
10 Electric will change because the BMGS tolling agreement with UED will be cancelled.
11 The proposed reclassification allows UNS Electric to increase cash flow by \$6 million
12 which is necessary to cover the costs of acquisition and ownership of BMGS. Without
13 such recovery, the financial position of UNS Electric would be significantly impaired.

14
15 **II. POST-TEST-YEAR PLANT.**

16
17 **Q. Dr. Fish's Surrebuttal Testimony addresses your testimony that the post-test year**
18 **plant should be included in rate base and asserts that plant is construction work in**
19 **progress ("CWIP"). Could you respond?**

20 A. Although my testimony provided an overview of the Company's request to include non-
21 revenue post-test year plant in rate base, Mr. Dallas Dukes addresses this issue in more
22 detail. In general, UNS Electric believes including such plant in rate base is appropriate
23 because: (i) it improves operational flexibility, maintains service levels and system
24 reliability; (ii) it has no material impact to revenues or expenses; (iii) the plant is
25 necessary regardless of whether zero customers are added or 1,000 customers are added;
26 (iv) the majority of plant being requested is already in service or will be by the time a rate
27

1 order is issued in this case; and (v) there is persuasive precedent that supports the
2 Company's request.

3
4 **III. FUEL AND PURCHASED POWER ISSUES.**

5
6 **Q. What was Staff's response to the Company's request to include \$195,500 in base**
7 **rates for credit support costs?**

8 A. Quite frankly, I am not exactly sure. Dr. Fish had implied that the Company should
9 seek recovery of these costs in base rates and not through its purchased power and fuel
10 adjustor clause (PPFAC) (see page 49 of his Direct Testimony). The Company did
11 make that proposal, and Mr. Grant explained on page 28 of his Rebuttal Testimony the
12 basis for the Company's request. Now it appears that Dr. Fish is arguing against this
13 adjustment – by stating that “the Company does not offer a pro forma adjustment to
14 remove those expenses from revenue requirement.” But as Mr. Grant clearly indicates
15 on page 11 of his Rejoinder Testimony that (i) these costs are recorded as interest
16 expense; and (ii) these costs, however, are *not* included in the Company's initial
17 revenue requirement because they were not included in UNS Electric's cost of long-
18 term debt. So the expenses for credit support were never included in the initial revenue
19 requirement. The Company is now requesting a pro forma adjustment to operating
20 expenses as an alternative to including credit support costs in the PPFAC.

21
22 I stress that it is the Company's understanding that Dr. Fish is not disputing the credit
23 support costs as reasonable – just that those costs are more properly recovered in base
24 rates. If that is the case, then the Company's proposed pro forma adjustment of
25 \$195,500 is reasonable based on all of the evidence the Company has provided in this
26 case.

1 **Q. Do you have any response to Dr. Fish's Surrebuttal Testimony at pages 6-7 that (i)**
2 **there is a disconnect between identification of a source of purchased power versus**
3 **actual procurement; and (ii) recommends independent periodic audits of the**
4 **Company's procurement practices?**

5 **A. Dr. Fish does not identify any specific problems so it is difficult to determine what**
6 **needs to be audited and if such an audit would be beneficial or cost effective.**

7
8 **IV. RESPONSE TO SURREBUTTAL TESTIMONY OF ASBA/AASBO WITNESS**
9 **CHUCK ESSIG.**

10
11 **Q. Mr. Essigs recommends that UNS Electric make several commitments in this rate**
12 **case regarding enhanced renewable energy and energy efficiency programs for**
13 **schools within UNS Electric's service territory – including establishing a separate**
14 **Time-of-Use rate for schools. What is the Company's response?**

15 **A. Mr. Essig states that UNS Electric should make commitments similar to what APS**
16 **agreed to in its rate case settlement agreement. I reiterate our willingness to work with**
17 **ASBA and AASBO to discuss and develop appropriate programs in the future.**
18 **However, the circumstances in this case are different that the APS settlement and the**
19 **Company cannot simply capitulate to something that APS may have agreed to in order**
20 **to reach a settlement agreement. Developing appropriate programs for schools that can**
21 **be integrated into the Company's other renewable and DSM programs will take some**
22 **time and careful consideration. Including school-specific programs in the next UNS**
23 **Electric Renewable Energy Implementation Plan and DSM programs allows programs**
24 **appropriate for UNS Electric to be developed. Moreover, developing a post-rate case**
25 **school-specific time-of-use rate raises some concerns about sufficient revenue recovery**
26 **and potential cross subsidiaries.**

1 **Q. Does this conclude your Rejoinder Testimony?**

2 **A. Yes.**

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1 **Q. Please state your name and business address.**

2 A. My name is Thomas A. McKenna. My business address is One South Church Avenue,
3 Tucson, Arizona 85701.

4
5 **Q. On whose behalf are you filing your Rebuttal Testimony in this proceeding?**

6 A. My Rejoinder Testimony is filed on behalf of UNS Electric, Inc. ("UNS Electric" or
7 "Company").

8
9 **Q. What areas will you be discussing in your Rebuttal Testimony?**

10 A. In my Rejoinder Testimony, I discuss:

- 11 • Staff's Surrebuttal Testimony regarding the Company's proposed treatment of the
- 12 Black Mountain Generating Station ("BMGS");
- 13 • Staff's Surrebuttal Testimony regarding the Company's proposed Rules and
- 14 Regulations; and
- 15 • Staff's Surrebuttal Testimony regarding engineering issues and the Company's
- 16 response.

17
18 **I. BLACK MOUNTAIN GENERATING STATION ("BMGS").**

19
20 **Q. Have you reviewed Dr. Fish's Surrebuttal Testimony regarding BMGS?**

21 A. Yes I have.

22
23 **Q. What is your response to his Surrebuttal Testimony?**

24 A. The Company continues to recommend inclusion of BMGS. I have provided detailed
25 descriptions of the many operational benefits BMGS will provide to UNS Electric and its
26 customers. These benefits are known and undisputed. The Company has provided Staff

27

1 all information it has requested about BMGS. So I believe Staff knows and is aware of
2 all of the information and facts about BMGS.

3
4 **II. RULES AND REGULATIONS.**

5
6 **Q. Did you review Staff witness Mr. Kenneth Rozen's Surrebuttal Testimony?**

7 **A. Yes.**

8
9 **Q. Mr. Rozen maintains – on pages 5 to 6 of his Surrebuttal Testimony – that the**
10 **Company should still be required to itemize material costs in the construction cost**
11 **estimates for line extensions. What is your response?**

12 **A. While the Company still has some reservations as to how effective this will be – as well**
13 **as being apprehensive about the potential ramifications I stated in my Rebuttal testimony**
14 **– the Company will itemize such costs in its line extension agreements.**

15
16 **Q. Mr. Rozen also seeks clarification regarding the new language in Subsection 9.D.**
17 **that states “. . .except if the difference is less than \$500. If the difference is less than**
18 **\$500, the amount may be billed or refunded according to the specific extension**
19 **agreement with the customer.” Please clarify.**

20 **A. I believe this is language that related back to the Company's original proposed rules and**
21 **regulations in this case, that included a proposal for a Facilities Operation Charge. The**
22 **Company is no longer proposing that charge as part of this case. Given the changes from**
23 **the Company's Direct testimony to its Rebuttal testimony in this case regarding the rules**
24 **and regulations, and upon further review, the Company no longer proposes this language.**
25 **Therefore, the Company amends its request for just the following language to Subsection**
26 **9.D.1.:**

1 D. Conditions Governing Extensions of Electric Distribution Lines and Services
2 Line extension measurements will be along the route of construction
3 required. This measurement will include primary, secondary and service
4 lines.

- 5 1. Prior to the installation of facilities, the Customer will be
6 required to pay the estimated cost of the construction of the
7 distribution facilities. Upon completion of construction the
8 Company will compare actual cost to the estimated cost
9 and any difference will be either billed or refunded to the
10 Customer.

11 Q. How does the Company respond to Staff's recommendation that the Commission
12 consider granting a waiver to A.A.C. R14-2-207.C. for UNS Electric in this
13 proceeding?

14 A. The Company supports that recommendation and believes an explicit waiver would
15 clarify the Commission's present policy regarding free footage.

16 **III. ENGINEERING ISSUES.**

17 Q. Staff witness W. Michael Lewis believes that the Company may be reluctant to
18 employ thermal scanning at the BMGS substation (see page 2 of his Surrebuttal
19 Testimony). Is that the case?

20 A. No. The Company, however, should be allowed to determine the appropriate timing of
21 any scan as part of its overall system maintenance. Such scans are labor intensive and
22 would needlessly increase expenses and interfere with other operation and maintenance
23 activities if the Company was required to conduct scans at the BMGS substation on a
24 particular, yet unnecessary schedule. Though not performed annually, thermal scanning
25 is performed by UES Substation Technicians as part of the procedure during maintenance
26 and substation down time. Thermal scanning is also used when equipment (connectors,
27 switches, insulators, underground terminators, etc.) is suspect. This approach to

1 maintenance has worked well at UNS Electric based on limited personnel having been
2 trained on the use of this specialized equipment and cost considerations.

3
4 **Q. Do you have anything to add regarding the Company's response to Mr. Lewis'**
5 **recommendation that UNS Electric list the worst performing circuits in an annual**
6 **report of the distribution indices?**

7 A. Such a requirement is unnecessary given the Company's current system reliability
8 monitoring and maintenance. Though UES does not record or report its "Worse
9 Performing Circuits", UES does track and review circuit and lateral performance through
10 its daily Trouble Tickets and Outage Reports. Outage and Trouble Tickets not only
11 identify outages and the number of outage, they are also used to identify voltage issues,
12 equipment or facility problems. This information is then used for future planning or for
13 immediate resolution. The Company also collects SAIFI (System Average Interruption
14 Frequency Index) and CAIDI (Customer Average Interruption Duration Index) data on a
15 regular basis. That data is reviewed for operational and reliability issues and is also
16 submitted to the Commission. These indices provide additional data regarding the
17 reliability of the UNS Electric distribution system, and the data is used in our evaluation
18 of needed repairs and upgrades. Listing "worst performing circuits" effectively
19 duplicates the Company's current reliability monitoring and really does not incorporate
20 other important reliability considerations such as the number of customers affected or the
21 cost of maintenance, repair or upgrade for a particular circuit.

22
23 **Q. Does this conclude your Rejoinder Testimony?**

24 A. Yes.
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Exhibits

Exhibit KCG-5 Compound Growth Rate of RCN Plant Escalation

1 **Q. Please state your name and business address.**

2 A. My name is Kentton C. Grant. My business address is One South Church Avenue,
3 Tucson, Arizona 85701.

4
5 **Q. Are you the same Kentton C. Grant who filed Direct and Rebuttal Testimony in**
6 **this case?**

7 A. Yes.

8
9 **Q. On whose behalf are you filing your Rejoinder Testimony in this proceeding?**

10 A. My Testimony is filed on behalf of UNS Electric, Inc ("UNS Electric" or the
11 "Company").

12
13 **Q. What is the purpose of your Rejoinder Testimony in this proceeding?**

14 A. The purpose of my Rejoinder Testimony is to respond to portions of the surrebuttal
15 testimony of Mr. David C. Parcell and Dr. Thomas H. Fish filed by the Arizona
16 Corporation Commission Staff ("Staff"), as well as portions of the surrebuttal testimony
17 of Mr. William A. Rigsby and Dr. Ben Johnson filed by the Residential Utility
18 Consumers Office ("RUCO"). The subject matter addressed in my Rejoinder Testimony
19 includes: (i) the proposed purchase and rate base treatment of the Black Mountain
20 Generating Station ("BMGS"), (ii) the determination of a fair rate of return ("ROR") on
21 fair value rate base ("FVRB"), (iii) the ability of UNS Electric to earn its cost of capital
22 and (iv) the recovery of credit support costs incurred as part of the Company's natural gas
23 and wholesale power procurement, either through base rates or through the Company's
24 purchased power and fuel adjustor clause ("PPFAC").

1 **I. PROPOSED PURCHASE OF THE BMGS.**

2
3 **A. Response to Staff Witness Thomas H. Fish.**

4
5 **Q. What portion of Dr. Fish's surrebuttal testimony on the BMGS do you wish to**
6 **respond to?**

7 A. I would like to clear up some fundamental misconceptions of the Company's proposal
8 that are presented on page 17 of Dr. Fish's surrebuttal testimony. These misconceptions
9 involve (i) the impact of the Company's proposal on UNS Electric's cash flow and (ii)
10 the impact of the Company's proposal on the rates to be paid by UNS Electric customers.
11

12 **Q. Please explain your first concern.**

13 A. On page 17 of his surrebuttal testimony, lines 10-16, Dr. Fish attempts to describe the
14 cash flow impact of the Company's proposed rate reclassification on UNS Electric's cash
15 flow. In the last sentence of this section, he concludes that "if revenue neutrality is to be
16 maintained, total cash in and out should not be affected." This statement is simply not
17 correct. As described on pages 4 and 5 of my Direct Testimony, UNS Electric's net
18 operating cash flow is expected to increase by approximately \$6 million per year if the
19 BMGS is placed into rate base and the proposed rate reclassification is approved. While
20 it is true that the total "cash in" from customers will not change as a result of the rate
21 reclassification, the total "cash out" from UNS Electric will indeed change due to the
22 cancellation of the BMGS tolling agreement with UniSource Energy Development
23 Company. Consequently, the proposed rate reclassification should not be viewed as
24 being cash flow neutral to UNS Electric. Instead, inclusion of the BMGS in rate base,
25 coupled with the proposed rate reclassification, is clearly necessary if UNS Electric is to
26 service the additional capital needed to purchase this facility.
27

1 **Q. What is the second concern you would like to address?**

2 A. On page 17 of his surrebuttal testimony, lines 18-24, Dr. Fish makes certain statements
3 that cast doubt on the revenue neutrality of the Company's proposed rate treatment of the
4 BMGS. Specifically, on line 20, Dr. Fish states that "Mr. Grant seems to be implying
5 that the Company will seek additional rate relief upon acquisition of BMGS." This
6 statement simply has no basis in fact.

7
8 **Q. Please explain.**

9 A. As described on page 11 of my Direct Testimony, beginning on line 22, customers will
10 see no net change in the price paid for electric service as a result of the rate
11 reclassification. Although the Company's non-fuel base rate would increase by
12 approximately 0.7 cents/kWh, UNS Electric's charge for fuel and purchased power costs
13 would decrease by this same amount. Additionally, as discussed on page 5 of my Direct
14 Testimony, beginning on line 18, the non-fuel revenue requirement for the BMGS is
15 projected to decrease over time under traditional rate base treatment. Consequently, it is
16 clearly inappropriate to imply that the acquisition of the BMGS by UNS Electric will
17 cause the Company to seek additional rate relief above and beyond what is being
18 requested in this rate case.

19

20 **II. RATE OF RETURN ON FAIR VALUE RATE BASE.**

21

22 **A. Response to Staff Witness David C. Parcell.**

23

24 **Q. What comments do you have to offer in response to Mr. Parcell's surrebuttal**
25 **testimony on the ROR to be applied to FVRB?**

26 A. I have several comments. First, contrary to his discussion appearing on page 6 of his
27 surrebuttal testimony, lines 19-25, the assignment of a zero cost of capital to the "fair

1 value increment" of rate base is indeed mathematically equivalent to the now discredited
2 "backing-in method" of determining the ROR on FVRB.

3
4 Second, with regard to Mr. Parcell's discussion of which method may or may not have
5 been adopted or considered in prior rate cases, which is found on page 7 of his surrebuttal
6 testimony, the simple fact of the matter is Mr. Parcell offers no substantive reason for
7 calculating the ROR on FVRB differently for UNS Electric than the methods recently
8 adopted by the Commission in both the Chaparral City Remand Order (Decision No.
9 70441 (July 28, 2008)) and the follow-up Chaparral City Water Company rate case
10 (Decision No. 71308 (October 21, 2009)). Moreover, although Mr. Parcell indicates that
11 the Chaparral City Water methodologies were not adopted in the prior UNS Electric or
12 UNS Gas rate cases (Decision Nos. 70360 (May 28, 2008) and 70011 (November 27,
13 2007)), that is because the actual Chaparral City Water decisions had not yet been issued.
14 The Commission has since rendered a decision in each of the Chaparral City Water
15 cases, and those methodologies should be applied here.

16
17 Finally, I found Mr. Parcell's discussion of mathematical errors, one new and one old, to
18 be somewhat perplexing. In this discussion, which appears on pages 7-10 of his
19 surrebuttal testimony, Mr. Parcell admits that his original recommended ROR of 5.99%
20 on FVRB should have been 6.14%, except that due to another error he explains that it
21 should have really been 6.01%. Then he concludes by saying that regardless of which
22 ROR value is used, Staff's revenue requirement would remain the same. While I
23 understand the math behind Mr. Parcell's explanation, this entire discussion illustrates the
24 importance of form over substance in his recommended approach.

1 Q. With regard to your first point above, please explain how the assignment of a zero
2 cost of capital (0.0%) to the "fair value increment" is mathematically equivalent to
3 the "backing-in" method.

4 A. Certainly. If you look at the bottom of Schedule 15 attached to Mr. Parcell's surrebuttal
5 testimony, where he calculates a 6.01% ROR on FVRB using a 1.50% cost of capital for
6 the "FVRB Increment," it is apparent that a ROR on FVRB of 5.49% would be obtained
7 if a zero cost of capital (0.0%) were applied to the "FVRB Increment" instead of the
8 1.50% value used in that schedule:

9
$$6.01\% - 0.52\% = 5.49\%$$

10 or alternatively,

11
$$2.50\% + 2.99\% = 5.49\%$$

12
13 This value also happens to equal the ROR that would be obtained by dividing Staff's
14 required operating income of \$14,153,519 (original cost basis) by Staff's fair value rate
15 base of \$257,827,428 from Schedule THF A-1 attached to Dr. Fish's direct testimony:

16
17
$$\$14,153,519 / \$257,827,428 = 5.49\%$$

18
19 This second method of calculating a ROR on FVRB of 5.49%, commonly referred to as
20 the "backing-in" method, is the very method that was rejected by the Arizona Court of
21 Appeals in the Chaparral City Remand Case. The result obtained is mathematically
22 equivalent to Mr. Parcell's primary recommendation in this case, where a zero percent
23 cost of capital is assigned to the "fair value increment" of rate base.

1 **Q. With regard to your second and third points above, why is it important that a**
2 **substantive reason be established for deviating from the calculation methods**
3 **adopted by the Commission in Decision Nos. 70441 and 71308?**

4 A. From the standpoint of fairness, as well as financial theory, it is difficult to understand
5 why one calculation methodology would be appropriate for one utility (e.g. Chaparral
6 City Water Company) and a completely different methodology would be appropriate for
7 another utility (e.g. UNS Electric). Nearly all investor-owned utilities employ a mix of
8 debt and equity capital in their capital structures. Most utilities also have a FVRB
9 (determined using replacement cost information) that exceeds the value determined for
10 OCRB. In light of these similarities, it stands to reason that the method for determining
11 the ROR on FVRB should be relatively uniform across most utilities. Additionally, if an
12 established calculation methodology provides a utility with a reasonable opportunity to
13 earn its cost of capital, and an alternative method does not, it is difficult to understand
14 why the alternative method should even be considered. For these reasons, as well as
15 others outlined in my Rebuttal Testimony, Mr. Parcell's alternative approach to
16 calculating the ROR on FVRB should be rejected.

17
18 **Q. Are you recommending that a "one size fits all" method for determining the ROR**
19 **on FVRB be adopted by the Commission?**

20 A. No. While I believe it is important that the Commission adopt a standard methodology
21 for use in utility rate proceedings, adjustments or refinements to that methodology should
22 be considered and allowed on a case by case basis. That is precisely the approach taken
23 by UNS Electric in this case. As described on pages 13-15 of my Direct Testimony, the
24 Company filed its rate request using a ROR on FVRB that was discounted from the ROR
25 that could otherwise be justified using the approaches adopted by the Commission in
26 Decision Nos. 70441 and 71308. This was done to in order to limit the rate impact on our
27 customers and to provide UNS Electric with an opportunity to earn its cost of capital and

1 nothing more. Additionally, the Company made a further adjustment to the ROR on
2 FVRB to reflect the incremental cost of capital needed to purchase the BMGS if that
3 facility is placed into rate base. These adjustments to the ROR resulting from the
4 methodology adopted by the Commission in Decision No. 70441, and the refinement to
5 that methodology adopted in Decision No. 71308, were made to fit the particular facts
6 and circumstances facing UNS Electric. By contrast, Mr. Parcell's recommended method
7 is based on a completely different formulaic approach and does not take into account the
8 unique facts and circumstances facing UNS Electric.

9
10 **B. Response to RUCO Witness Ben Johnson.**

11
12 **Q. What comments do you have in response to Dr. Johnson's surrebuttal testimony?**

13 **A.** My comments are focused on two key points. First, I address Dr. Johnson's assertion that
14 utility plant reproduction costs tend to grow faster than the overall rate of inflation, a
15 belief that he uses to justify a lower ROR on FVRB. Second, I comment once again on
16 the importance of adjusting the ROR on FVRB to reflect the cost of capital needed to
17 acquire the BMGS, an adjustment that RUCO failed to make in their initial filing and a
18 point that Dr. Johnson declined to address in his surrebuttal testimony.

19
20 **Q. On page 4 of his surrebuttal testimony, lines 10-11, Dr. Johnson states that "RCND**
21 **has a tendency to grow faster than the overall rate of inflation." Do you agree that**
22 **utility plant replacement costs tend to grow faster than the overall rate of inflation?**

23 **A.** The answer depends on what specific type of utility plant is being considered. For UNS
24 Electric, it appears that plant replacement costs have grown at a rate that is only slightly
25 higher than the overall rate of inflation as measured by the Consumer Price Index
26 ("CPI").
27

1 **Q. How did you reach this conclusion?**

2 A. I examined the historical escalation rates used by the Company to derive the replacement
3 cost new ("RCN") plant value of \$844.3 million appearing on line 1 of Schedule B-1.
4 Compound average growth rates over the 25 years (ending 12/31/08) were calculated for
5 each plant category having over \$20 million of RCN value at the end of the test year. In
6 aggregate, these plant categories comprise 86% of the total RCN plant value calculated as
7 of the end of the test year. As may be seen on Exhibit KCG-5 attached to this Rejoinder
8 Testimony, the weighted average compound growth rate resulting from the RCN plant
9 escalation rates used by UNS Electric is 3.32% over the period 1983-2008. Over this
10 same 25 year period, the CPI grew by 2.96%. Consequently, although RCN growth rates
11 are not identical to the overall rate of inflation, particularly for any given year, over the
12 long-run it is reasonable to conclude that on average, plant replacement costs for UNS
13 Electric have grown at a rate comparable to that of overall inflation.

14
15 **Q. You mention above that RUCO did not adjust the ROR on FVRB to reflect the cost**
16 **of capital required to purchase the BMGS. Why is such an adjustment important if**
17 **the BMGS is purchased and included in rate base?**

18 A. As discussed on pages 15-16 of my Direct Testimony, and again on page 9 of my
19 Rebuttal Testimony, it is important that the overall ROR on FVRB reflect a weighted
20 average of the ROR on non-BMGS rate base and the cost of capital for the BMGS
21 portion of rate base. This adjustment is necessary because there is only a minimal
22 difference between the original cost of the BMGS and the fair value of that facility as
23 traditionally determined by the Commission. If such an adjustment is not made, UNS
24 Electric will not be provided with an opportunity to earn its cost of capital on its proposed
25 investment in the BMGS.

1 **III. ABILITY OF UNS ELECTRIC TO EARN ITS COST OF CAPITAL.**

2
3 **A. Response to Staff Witness David C. Parcell.**

4
5 **Q. Mr. Grant, is UNS Electric seeking a “guaranteed return” as implied by Mr. Parcell**
6 **on page 6 of his surrebuttal testimony, lines 12-16?**

7 A. No. UNS Electric is simply asking that it be provided with a reasonable opportunity to
8 earn its cost of capital. As discussed on pages 22-24 of my Rebuttal Testimony, Staff’s
9 recommended revenue requirement would not provide UNS Electric with any realistic
10 opportunity to earn a reasonable rate of return on its invested capital. In light of the fact
11 that UNS Electric was able to earn a return on equity (“ROE”) of only 6.9% during the
12 first twelve months under new rates resulting from its last general rate case, this is a
13 critical issue for the Company and its shareholders. Due to the impact on the Company’s
14 financial integrity and ability to attract capital, it also should be an issue of concern to
15 the Commission and UNS Electric’s customers.

16
17 **B. Response to RUCO Witness William A. Rigsby.**

18
19 **Q. What does Mr. Rigsby have to say with respect to the Company’s ability to earn its**
20 **cost of capital?**

21 A. On page 6 of his surrebuttal testimony Mr. Rigsby levels two key criticisms. First, he
22 labels the Company’s financial projections as “mere speculation.” Second, he asserts that
23 the Company has ignored RUCO’s recommendation to allow the BMGS in rate base,
24 which he says will “certainly help UNSE’s future financial position.”
25
26
27

1 **Q. What is your response to Mr. Rigsby's first criticism?**

2 A. While financial forecasts do not enjoy the same level of certainty as historical financial
3 statements, when properly prepared a financial forecast is not "mere speculation" as Mr.
4 Rigsby asserts. UniSource Energy Corporation employs a highly qualified staff of
5 financial professionals whose main responsibility is the development of financial
6 projections based on a rigorous analysis of trends in customer growth, sales, operating
7 revenues, operating expenses, capital spending needs, interest rate levels and other factors
8 affecting financial performance. For a company such as UNS Electric, which is engaged
9 in a single line of business having a relatively stable customer base, the preparation of a
10 financial forecast is a fairly straightforward exercise. All that is required are some decent
11 analytical tools, some professional judgment, and a financial forecasting model that is
12 capable of producing projected financial statements on a reliable and consistent basis.
13 The financial forecast summarized on page 18 of my Direct Testimony was prepared in
14 exactly this manner, and while not perfect, it serves as the best indication of how UNS
15 Electric will fare financially under the Company's rate request.

16
17 **Q. What do you have to say with respect to Mr. Rigsby's second criticism?**

18 A. While the inclusion of the BMGS in rate base is expected to improve the Company's
19 financial performance, the ability to earn a reasonable ROR on that investment would do
20 nothing to address the projected under-earning on UNS Electric's non-BMGS rate base
21 investment under RUCO's rate recommendation. Additionally, as noted earlier, RUCO
22 did not adjust Dr. Johnson's recommended ROR on FVRB of 5.96% to reflect the cost of
23 capital needed to acquire the BMGS. A ROR of only 5.96% on the proposed BMGS
24 investment would likely not even cover the cost of debt needed to purchase the facility,
25 let alone allow for a reasonable return on any equity invested in the purchase.
26 Consequently, due to the method by which RUCO included the BMGS in rate base and
27

1 its revenue requirement, the net result would actually be detrimental to UNS Electric's
2 earned return on capital.

3
4 **IV. CHANGES TO PURCHASED POWER AND FUEL ADJUSTOR CLAUSE.**

5
6 **A. Response to Staff Witness Thomas H. Fish.**

7
8 **Q. What comments do you have to offer in response to Doctor Fish's surrebuttal**
9 **testimony on PPFAC eligible costs?**

10 **A.** On page 6 of his surrebuttal testimony, lines 6-8, Doctor Fish admits that UNS Electric
11 does indeed incur expenses associated with credit support for its acquisition of wholesale
12 power. However, on lines 10-12, he goes on to imply that such expenses may already be
13 included in the Company's revenue requirement since "the Company does not offer a pro
14 forma adjustment to remove those expenses from its revenue requirement." Such an
15 implication is clearly off the mark, as the credit support costs referred to in my Direct and
16 Rebuttal Testimony are recorded as interest expense and not as an operating expense.
17 For rate making purposes, interest expense is typically recovered through the debt
18 component of the return on rate base. Since the letter of credit and short-term borrowing
19 costs that make up the cost of wholesale credit support were not included in UNS
20 Electric's cost of long-term debt, these costs of wholesale credit support were not
21 included in the Company's initial revenue requirement. Instead, recovery of these costs
22 was sought through the PPFAC. However, when Dr. Fish rejected this means of cost
23 recovery in his direct testimony and suggested that the Company recover these costs
24 through base rates as an operating expense, UNS Electric reacted to this development by
25 proposing that the annualized cost of credit support be included as a new pro forma
26 adjustment to the Company's non-fuel revenue requirement. (See my Rebuttal
27 Testimony, page 28.) Doctor Fish is incorrect to assume that these costs are somehow

1 buried in the Company's initial revenue requirement. Instead, UNS Electric should be
2 provided with an opportunity to recover these costs, which are quite substantial, either
3 through the PPFAC or through a \$195,500 pro forma adjustment to test-year operating
4 expense.

5
6 **Q. Does this conclude your Rejoinder Testimony?**

7 **A.** Yes, it does.
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EXHIBIT

KCG-5

Exhibit KCG-5

UNS Electric, Inc.
Compound Growth Rate of RCN Plant Escalation
12/31/83 to 12/31/08

FERC Account	Description	RCN Value at 12/31/08	% of Total	Compound Growth Rate of RCN Plant Escalation	Weighted Average Growth Rate
343	Prime Movers	21,806,582	3.02%	3.1%	0.09%
353	Station Equipment	43,128,870	5.97%	3.7%	0.22%
355	Poles & Fixtures	39,080,670	5.41%	3.1%	0.17%
356	Overhead Conductors & Devices	39,705,222	5.50%	4.0%	0.22%
362	Station Equipment	80,103,214	11.09%	3.6%	0.40%
364	Poles, Towers, & Fixtures	150,342,721	20.82%	2.5%	0.53%
365	Overhead Conductors & Devices	130,019,108	18.00%	3.8%	0.68%
366	Underground Conduit	23,715,667	3.28%	2.4%	0.08%
367	Underground Conductors & Devices	70,739,900	9.80%	3.7%	0.36%
368	Line Transformers	123,555,857	17.11%	3.4%	0.58%
		722,197,811	100.00%		3.32%

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KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-04204A-09-0206
UNS ELECTRIC, INC. FOR THE)
ESTABLISHMENT OF JUST AND)
REASONABLE RATES AND CHARGES)
DESIGNED TO REALIZE A REASONABLE)
RATE OF RETURN ON THE FAIR VALUE OF)
THE PROPERTIES OF UNS ELECTRIC, INC.)
DEVOTED TO ITS OPERATIONS)
THROUGHOUT THE STATE OF ARIZONA.)

January 25, 2010

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1 **Q. Please state your name and business address.**

2 A. My name is Martha B. Pritz. My business address is One South Church Avenue, Tucson,
3 Arizona.

4

5 **Q. What is the purpose of your Rejoinder Testimony in this proceeding?**

6 A. The purpose of my Rejoinder Testimony is to respond to portions of the Surrebuttal
7 Testimony filed by David C. Parcell on behalf of the Arizona Corporation Commission
8 Staff ("Staff") and by William A. Rigsby on behalf of the Residential Utility Consumer
9 Office ("RUCO").

10

11 **I. RESPONSE TO STAFF WITNESS DAVID C. PARCELL.**

12

13 **Q. Does Mr. Parcell offer updated Discounted Cash Flow ("DCF"), Capital Asset**
14 **Pricing Model ("CAPM") and Comparable Earnings ("CE") calculations in his**
15 **Surrebuttal Testimony?**

16 A. Yes. He presents the updated figures only for his DCF and CAPM analyses in the body
17 of his testimony, however updated analyses for all three methods are shown in his
18 attached exhibits.

19

20 **Q. Do his updates lead him to revise his original cost of equity recommendation of**
21 **10.0%?**

22 A. No, assuming that in his statement on page 11 that "the cost of capital for UNS Electric
23 remains at 10.0 percent....," he really intended to say the cost of *equity* remains at 10.0
24 percent.

25

26

27

1 **Q. Please assess the reasonableness of the 10.0% return on equity ("ROE")**
2 **recommended for UNS Electric.**

3 A. An investor would view UNS Electric as riskier than most other utilities since the
4 Company's earnings and cash flow do not enable it to pay a dividend. In exchange for
5 taking on greater risk in investing in UNS Electric, an investor would require a higher
6 rate of return. Therefore, a 10.0% return would not be adequate to attract investors.
7

8 **Q. What evidence can you offer that investors would require more than a 10.0% return**
9 **on equity for UNS Electric?**

10 A. First, I would refer to Mr. Parcell's Exhibit DCP-1 (Schedule 10) showing the historical
11 and prospective rates of return on average common equity for two groups of comparable
12 utilities. Looking at the prospective figures shown for the periods 2010 and 2012 – 2014,
13 roughly the window before the Company could file and settle another rate case, one sees
14 a range of average values from 8.6% to 10.4%. At first glance, the recommended 10.0%
15 return on equity seems in line with these returns. In fact, it is not because the returns
16 shown on Schedule 10 are projections of *earned* returns. Given the impact of regulatory
17 lag on returns, an *allowed* ROE of just 10.0% would almost certainly result in much
18 lower earned returns.
19

20 As Mr. Grant notes in his Rejoinder Testimony, UNS Electric had an *earned* return on
21 equity of just 6.9% for the first twelve months under new rates resulting from its last rate
22 case even though the *allowed* ROE was 10.0%.
23

24 **Q. How else might one assess the recommended 10.0% return on equity?**

25 A. One could compare the recommended return resulting from detailed analyses to the
26 allowed returns on equity granted in rate cases for other utilities to ascertain whether the
27 recommendation is reasonable.

1 **Q. What have been the allowed ROEs in other recent rate cases?**

2 A. For the thirty-nine rate orders issued in 2009, the average ROE was 10.52%. With the
3 exception of one outlier, the allowed ROEs ranged from 10.0% to 11.5%. As of this
4 writing, there have been five rate orders issued in 2010 with an average allowed ROE of
5 10.54%. The 2010 allowed ROEs range from 10.0% to 11.0%.

6
7 **Q. What do you conclude from your review of recently ordered returns on equity?**

8 A. While Mr. Parcell put considerable effort into the analyses that led to his recommended
9 return on equity, the resulting 10.0% figure appears unreasonably low when compared to
10 recent allowed ROEs. When one considers that investors would view UNS Electric as
11 riskier than other utilities, the inadequacy of the recommendation becomes even more
12 pronounced.

13
14 **II. RESPONSE TO RUCO WITNESS WILLIAM A. RIGSBY.**

15
16 **Q. What concerns do you have about Mr. Rigsby's use of the Capital Asset Pricing
17 Model ("CAPM") as discussed in his Surrebuttal Testimony?**

18 A. While I have reservations about both the risk-free rate of return and the risk premium
19 selected for use by Mr. Rigsby, I will focus on the resulting return on equity ("ROE")
20 ranges presented in his Direct Testimony and his Rebuttal Testimony.

21
22 **Q. What ROE ranges are indicated by Mr. Rigsby's CAPM calculations?**

23 A. In his Direct Testimony, Mr. Rigsby's model indicated a range of 5.46% to 6.83%. In his
24 Surrebuttal Testimony, he noted that with a slightly different range of risk premiums, his
25 model indicated an even lower range, 5.33% to 6.79%.

1 **Q. Are these ranges reasonable, given that the Company has a cost of debt of 7.05%?**

2 A. No, even the upper ends of the ranges are *below* the Company's cost of debt, but equity
3 investors would require a return on equity *higher* than that on debt as compensation for
4 the incremental risk they bear. This risk-return relationship is fundamental in financial
5 theory. As I noted in my Direct Testimony, a comparison of allowed ROEs to average
6 utility bond yields for the period from January 2006 through January 2009 shows an
7 average premium of 4.07%.

8
9 **Q. Given that RUCO's CAPM-indicated return on equity is below the Company's cost
10 of debt, should it be considered in the final determination of a fair rate of return on
11 equity?**

12 A. No, it should not.

13
14 **Q. Please comment on Mr. Rigsby's defense of his DCF analysis.**

15 A. Yes. I note that Mr. Rigsby discusses at length his calculation of the growth rate
16 estimate, which is a departure from more commonly-used methods of determining an
17 appropriate growth rate estimate. His calculation includes an adjustment based on his
18 assumption that investors will expect a company's market-to-book ratio to move toward a
19 ratio of 1.0. He bases this on the theory that if regulators set a utility's rate of return at a
20 level equal to the cost of capital of firms with similar risk, the utility's market-to-book
21 ratio will move toward a value of 1.0. He goes on to say that while fluctuations in
22 earnings may cause a utility's market-to-book ratio to vary, the average earnings over
23 time will result in a ratio of 1.0.

24
25 **Q. Is it indeed the case that utilities' market-to-book ratios average 1.0 over time?**

26 A. No. As seen in Staff witness David Parcell's Exhibit 10 to his Direct Testimony, the
27 market-to-book ratios for two groups of comparable utilities have averaged well-above

1 1.0. Restating the percentages shown on Mr. Parcell's schedule as ratios, the market-to-
2 book averages shown are 1.52, 1.29, 1.54 and 1.57 for the two groups of companies each
3 examined over two time periods.
4

5 **Q. If the adjustment, which appears to be unjustified, were removed, would the growth**
6 **rate estimate and indicated ROE be higher or lower than those calculated by Mr.**
7 **Rigsby?**

8 A. The growth rate and ROE would be higher. The ROE would be higher by 47 basis
9 points, 10.02% vs. the 9.55% from Mr. Rigsby's Direct Testimony.
10

11 **Q. Please discuss Mr. Rigsby's assessment of his final recommendation of 9.25% as an**
12 **appropriate cost of equity for UNS Electric.**

13 A. Mr. Rigsby says it has been suggested that if regulators set a utility's rate of return
14 slightly higher than that of firms with similar risk, it will send a message to investors that
15 average long-term earnings will not fall below expectations. He also says that because
16 his recommendation of 9.25% ROE is above the CAPM range he derived in his
17 Surrebuttal Testimony (5.33% to 6.79%), his recommendation is consistent with the
18 theory presented.
19

20 **Q. Is that conclusion reasonable?**

21 A. No, it is not. As I explained above, the CAPM-indicated ROE range is meaningless
22 because it is below the Company's cost of debt. Declaring a recommended rate of return
23 to be consistent with theory just because it is higher than an unusable range is similarly
24 meaningless.
25
26
27

1 **Q. Does Mr. Rigsby raise the question of whether you have prepared updates to the**
2 **cost of equity analyses presented in your Direct Testimony?**

3 A. Yes, he notes that I had not updated the analyses at the time I filed Rebuttal Testimony.
4

5 **Q. Have you since updated your analyses for the comparable company group you**
6 **examined?**

7 A. Yes, I have.
8

9 **Q. What are the results of your updated comparable company analyses?**

10 A. My updated DCF analysis indicates an 11.2% return on equity, my bond yield plus risk
11 premium ("BYRP) calculation shows 10.3%, and my CAPM analysis shows 8.9%.
12 Based on a comparison to typical risk premiums for equity relative to debt, the result of
13 the CAPM analysis appears too low to be meaningful. The average cost of equity
14 indicated by the other two methods, as updated, is 10.8%.
15

16 **Q. Have you revised your original recommendation of an 11.4% return on equity for**
17 **UNS Electric?**

18 A. No, based on a review of my original analyses, my updated analyses and current
19 developments affecting the outlook for financial markets, I am still comfortable that
20 11.4% is an appropriate ROE for the Company. Additionally, as noted above and in my
21 Direct and Rebuttal Testimony, UNS Electric is riskier from an equity investor's
22 perspective that the group of comparable companies I examined.
23

24 **Q. What factors in the outlook for financial markets play a role in your decision to**
25 **maintain your original ROE recommendation?**

26 A. There are two key factors, each likely to put upward pressure on the return on equity
27 required by investors. First, taxes on dividends and capital gains are expected to

1 increase. To offset this increase in taxes, investors will look for higher pre-tax returns on
2 their investments. Second, economic indicators show inflation may be increasing. An
3 increase in inflation will increase companies' cost of capital.

4
5 I'll address the impact of income tax rates first. In 2003, the Jobs Growth and Tax Relief
6 Reconciliation Act ("JGTRRA") was enacted, reducing capital gains tax rates from 20%
7 to 15% and reducing the tax rate on qualified dividends from a taxpayer's ordinary
8 marginal tax rate to 15%. (For taxpayers in lower tax brackets, the capital gains and
9 dividend tax rates are lower still.) The rate decreases were originally set to expire in
10 2008, but were extended through December 31, 2010 by the Tax Increase Prevention and
11 Reconciliation Act of 2005. Barring another extension, taxes will revert to 2002 rates in
12 2011.

13
14 To gauge the potential impact of this increase in income tax rates on the cost of equity,
15 one can look to the impact on the cost of equity that the decrease in rates had when it was
16 put into effect. The Federal Reserve Bank of Boston estimated that the tax cuts reduced
17 the economy-wide cost of equity by 50 to 100 basis points.¹

18
19 Of course, the impact of an increase in the dividend tax rate is even more pronounced for
20 higher-yielding stocks like utility stocks. The *Journal of Financial Planning* addressed
21 this in general terms, saying, "What will happen to high dividend-yielding equities if the
22 special tax rate on qualified dividends sunsets or is repealed...? Evidence would suggest
23 that dividend-heavy stocks and indices won't do well."²

24
25
26 ¹ Richard W. Kopcke, "The Taxation of Equity, Dividends, and Stock Prices", *Public Policy Discussion*
27 *Papers*, (Federal Reserve Bank of Boston, January 2005), 18.

² Michael Finke, Ph.D., CFP and Tom Langdon, JD, CFP, "Capital Gains and Dividend Tax Rates Will
Likely Increase in 2009; Will You Be Prepared?" *Journal of Financial Planning* (August 2008): 2.

1 Another reason to anticipate an increase in the cost of equity is the possibility of
2 increasing inflation due to unprecedented U.S. budget deficits coupled with the recent
3 easing in monetary policy. Increasing inflation would increase risk-free rates and,
4 therefore, companies' cost of capital. Indeed, implied inflation as measured by the
5 difference between nominal constant maturity Treasuries and TIPS constant maturity
6 treasuries increased by approximately 50 basis points in just the period from September
7 to December 2009.

8
9 In addition, in November 2009, James Bullard, president of the Federal Reserve Bank of
10 St. Louis, told the *Financial Times* that while the U.S. central bank still had to contend
11 with the threat of deflation at that point, it might have to "pivot quickly once this danger
12 passed to face the threat of excess inflation."³

13
14 **Q. Does this conclude your Rejoinder Testimony?**

15 **A.** Yes, it does.
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27 ³ Guha, Krishna. "Uncertainty "high" over inflation outlook", *Financial Times* (FT.com), November 8, 2009.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF)	DOCKET NO. E-04204A-09-0206
UNS ELECTRIC, INC. FOR THE)	
ESTABLISHMENT OF JUST AND)	
REASONABLE RATES AND CHARGES)	
DESIGNED TO REALIZE A REASONABLE)	
RATE OF RETURN ON THE FAIR VALUE OF)	
THE PROPERTIES OF UNS ELECTRIC, INC.)	
DEVOTED TO ITS OPERATIONS)	
THROUGHOUT THE STATE OF ARIZONA.)	
)	
)	

Rejoinder Testimony of

Dallas J. Dukes

on Behalf of

UNS Electric, Inc.

January 25, 2010

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Exhibits:

Exhibit DJD-3: Comparison of Adjustments to Revenue Requirements

Exhibit DJD-4 Income Tax Calculation Comparison

1 **Q. Please state your name and business address.**

2 A. My name is Dallas J. Dukes. My business address is One South Church Avenue, Tucson,
3 Arizona.

4
5 **Q. On whose behalf are you filing Rejoinder Testimony in this proceeding?**

6 A. My testimony is filed on behalf of UNS Electric, Inc.
7

8 **Q. What is the purpose of your Rejoinder Testimony in this proceeding?**

9 A. The purpose of my Rejoinder Testimony is to address certain adjustments that Staff
10 Witness Dr. Thomas H. Fish ("Dr. Fish") discusses in his Surrebuttal Testimony. I also
11 address several adjustments that Residential Utility Consumer Office ("RUCO") witness
12 Dr. Ben Johnson ("Dr. Johnson") discusses in his Surrebuttal Testimony.
13

14 **Q. Have you updated or made any changes to your revenue requirement or schedules
15 as submitted with your Rebuttal testimony?**

16 A. Yes. I have attached a revised "Comparison of Adjustments to Revenue Requirements"
17 as Rejoinder Exhibit DJD-3. This exhibit compares the Company's final position in
18 comparison to Staff and RUCO's positions as presented in their Surrebuttal filings.
19

20 **I. REJOINDER TO RATE BASE ADJUSTMENTS.**

21
22 **A. Post Test Year Non-Revenue Plant in Service.**

23
24 **Q. Do Staff and RUCO still disagree with the Company's inclusion of Post Test Year
25 Non Revenue Plant in Service within rate base?**

26 A. Yes. Staff's witness, Dr. Fish addresses the adjustment specifically in his Surrebuttal
27 Testimony. RUCO's witness, Dr. Johnson, does not specifically address the adjustment

1 within his Surrebuttal Testimony, but I believe RUCO continues to object to including
2 post test year plant ("PTYP") in rate base.

3
4 **Q. Has the basis for Dr. Fish's removal of the Company's Post Test Year Non Revenue**
5 **Plant in Service adjustment changed from that of their direct filings?**

6 A. No. Dr. Fish continues to argue that post-test year plant should only be included in rate
7 base in rare occasions when a utility finds itself in serious financial trouble.

8
9 **Q. Do you agree with this standard?**

10 A. No. UNS Electric does not believe the Commission should have its discretion and
11 judgment to include PTYP in rate base limited only to situations where a Utility is in
12 serious financial trouble or to maintain financial viability. Including PTYP or a portion
13 of PTYP that does not materially increase revenue or decrease cost should be a tool the
14 Commission uses to insure that UNS Electric has a reasonable opportunity to earn a
15 reasonable and fair return.

16
17 **Q. Has the Commission always required such a showing of "serious" financial trouble**
18 **in past cases?**

19 A. No. The Commission has rejected such arguments before. For example, in Decision No.
20 65350, the Commission stated that "We do not agree with Staff and RUCO that the
21 Commission has always required extraordinary circumstances to allow post test year
22 plant."¹

23
24 **Q. What criteria has the Commission established?**

25 A. The Commission summarized its past cases as follows: "In the past, the Commission has
26 allowed the inclusion of post test year plant in circumstances where the new plant is
27

¹ Decision No. 65350 (Nov. 1, 2002) at 11:21-23.

1 revenue neutral and there is no evidence of a material mismatch between revenue and
2 expenses and where the post test year plant is required for system reliability or to provide
3 adequate service.”²
4

5 **Q. Does UNS Electric’s requested post test year plant satisfy these criteria?**

6 A. Yes. The post test year plant is plant whose primary purpose is to serve existing
7 customers and which would have been replaced regardless of customer growth. As I
8 have explained, there will not be a material impact on revenue or expenses.
9

10 **B. Cash Working Capital.**
11

12 **Q. Did Staff revise its Cash Working Capital adjustment in their Surrebuttal filing?**

13 A. Yes. Dr. Fish did correct the error in his Direct testimony where his adjustment was
14 reflected in his “B” schedules as a decrease rather than an increase. However, Dr. Fish
15 did not synchronize it with his other adjustments to completely reflect all of Staff’s
16 Surrebuttal changes.
17

18 **Q. Did RUCO provide a revised Cash Working Capital adjustment in its Surrebuttal**
19 **filing?**

20 A. No. RUCO did not provide revised Schedules and/or adjustments with its Surrebuttal
21 filing.
22
23
24
25
26
27

² Decision No. 67279 (Oct. 5, 2004) at 6:7-10.

1 **II. REJOINDER TO OPERATING EXPENSE ADJUSTMENTS.**

2
3 **A. Pension and Benefits Expense.**

4
5 **Q. Has RUCO changed its position on the Pension and Benefit Expense adjustment**
6 **proposed by the Company?**

7 A. Yes. In his Surrebuttal testimony RUCO witness Dr. Johnson revised his position and
8 accepted the Company's adjustment.

9
10 **B. Call Center.**

11
12 **Q. Did Staff address its proposed Call Center adjustment in Surrebuttal testimony?**

13 A. Yes. Dr. Fish addresses a correction to his Direct testimony position that I proposed in
14 my Rebuttal testimony. However, Staff's proposed adjustment on Call Center expense is
15 still inappropriate. The Company is seeking only the actual test year Call Center
16 expense. RUCO has not opposed this expense. Staff's rationale for the adjustment, even
17 though it has reduced the negative adjustment, is still flawed for the reasons I set forth in
18 my Rebuttal.

19
20 **Q. Do you have any other comments regarding Dr. Fish's Surrebuttal testimony for**
21 **Call Center Expense?**

22 A. Yes. Dr. Fish's Surrebuttal testimony states that in developing its initial position, Staff
23 used the Call Center information pointed to by the Company in its response to Staff's
24 Data Request STF 5.3. That statement is wrong and appears to imply that the Company
25 somehow led Dr. Fish to the incorrect information.

1 In fact, STF 5.3 asked only for intercompany invoices for 2006 through 2009. In
2 response to STF 5.3, the Company indicated that it provided all of the intercompany
3 invoices for 2007, 2008 and the first half of 2009 through its response to STF 3.30 (2006
4 invoices were excluded because they were already supplied to Staff in Data Request 3.57
5 (in the UNS Electric's last rate case). But Dr. Fish needed 2005 invoices to properly
6 calculate the call center expense allocated to UNS Electric for the 12 months ending June
7 2006. That was the test year in the last UNS Electric rate case. Dr. Fish did not request
8 the 2005 invoices in STF 5.3 or any other data request that I could find.

9
10 Had Dr. Fish asked for the UNS Electric call center expense included in the last test year
11 or had UNS Electric known that Dr. Fish needed the information for his direct filing, we
12 would have provided the information to him during the discovery process as quickly as
13 possible.

14
15 **C. Rate Case Expense.**

16
17 **Q. Do you have any comments regarding Dr. Fish's Surrebuttal testimony for Rate**
18 **Case Expense?**

19 **A.** Yes. Dr. Fish's Surrebuttal testimony implies that UNS Electric is asking for recovery of
20 "extra" rate case expense. UNS Electric is not asking for recovery of extra cost. On the
21 contrary, UNS Electric is requesting recovery of less than the actual cost it will incur.
22 The issue is that UNS Electric does not have a legal or rates department like Southwest
23 Gas, and employs outside legal and regulatory support from TEP and other consultants.
24 At the requested level of annual recovery of \$138,890 it is certainly more cost effective to
25 use external resources as opposed to UNS Electric hiring a fulltime staff, providing them
26 office space and the equipment to do the job.

1 **D. Bad Debt Expense.**

2
3 **Q. Do you have any comments regarding Dr. Fish's Surrebuttal testimony related to**
4 **Bad Debt Expense?**

5 A. Dr. Fish corrected his inadvertent error in his direct filing where he put the adjustment in
6 to his "C" schedules as a reduction to the Company's pro forma bad debt expense rather
7 than as an increase.

8
9 **Q. Even so, do you agree with Dr. Fish's bad debt adjustment as corrected?**

10 A. No. I think it overstates the expense and I believe the Company's version is consistent
11 with normal convention. The Company simply calculated the three year average of bad
12 debt expense to retail revenue and then applied it to pro forma test year retail revenue. I
13 do not see any mismatch in that calculation as it synchronizes the historical percentage of
14 write-off as a percentage of retail revenue with the adjusted level based on annualizing
15 and weather-normalizing the test year information. It is simply the classic way of making
16 that adjustment.

17
18 **E. Outside Legal Expense.**

19
20 **Q. Did Dr. Fish propose a revised Outside Legal Expense adjustment in his Surrebuttal**
21 **testimony?**

22 A. Yes. He proposed a four-year average.

23
24 **Q. Do you have an opinion concerning Dr. Fish's four year average proposed?**

25 A. Yes. The goal of normalizing outside legal cost is to include a normal and reasonable
26 level of cost in the cost of service. The problem with outside legal cost is that they are
27 irregular. In other words, outside legal costs can fluctuate significantly – depending on

1 the legal actions necessary that are primarily outside the control of the Company.
2 Therefore, Staff, RUCO and the Company all proposed differing average levels by
3 choosing different time periods to average. The Company believes its three-year average
4 provides a reasonable level of recurring cost recovery.

5
6 **F. Wholesale Credit Support.**

7
8 **Q. Did Dr. Fish address the Company's request to include Wholesale Credit Support**
9 **within revenue requirements as a cost of service to be recovered through rates**
10 **established in this case?**

11 **A.** Sort of. In the Company's direct filing we requested the Commission's approval to
12 recover credit support costs through the PPFAC process. In his Direct testimony, Dr.
13 Fish stated that those costs are not PPFAC-eligible cost and should be properly recovered
14 through base rates. So in the Company's Rebuttal filing we included an annualized level
15 of wholesale credit support cost within pro forma operating expenses (\$195,500). That
16 adjustment was sponsored by Company witness, Kentton C. Grant, and is shown both on
17 Exhibit DJD-2 of my Rebuttal testimony and within the workpapers supplied to Staff in
18 support of the Rebuttal testimony. Then Dr. Fish, on page 6 of his Surrebuttal testimony,
19 states the following:

20
21 **Q. Does the Company incur expenses associated with credit support for its acquisition**
22 **of wholesale power?**

23 **A.** Yes.

24 **Q. Did the Company remove those expenses in calculating its revenue requirement?**

25 **A.** The Company does not offer a pro forma adjustment to remove those expenses from its
26 revenue requirement. They were not included in the PPFAC for recovery.
27

1 **Q. Why does the Company propose an adjustment to include Wholesale Credit**
2 **Support cost and not an adjustment to remove them as suggested by Dr. Fish?**

3 A. Wholesale credit support costs are interest expense associated with financing the activity
4 and the lost interest income associated with posting cash with third parties in support of
5 the activity. Therefore, there would be no expense within test year operating expenses;
6 just like customer deposit interest expense is not in test year operating expenses. For
7 ratemaking purposes, one must make a pro forma adjustment for interest cost (such as for
8 customer deposits) into revenue requirements. Basically these interest cost are deemed to
9 be in support of providing customer service and are treated like an operating cost for
10 ratemaking purposes. That is why we do not have a pro forma adjustment removing the
11 expense, but we have one adding it in.

12
13 **G. Income Tax Expense.**

14
15 **Q. Do you have concerns with Dr. Fish's calculation of normalized income taxes in his**
16 **Surrebuttal filing?**

17 A. Yes. In his Surrebuttal, Dr. Fish modified his Income Tax Expense adjustment
18 methodology resulting in a mismatched change in income tax expense without any
19 explanation or justification. This unsupported change would have the impact of reducing
20 the Company's revenue requirement proposed by Staff by \$508,000. As set forth below,
21 Dr. Fish's methodology used to calculate income taxes is contrary to accepted
22 Commission practice regarding Income Tax expense. Dr. Fish has changed his
23 methodology for calculating normalized income taxes in his Surrebuttal. In his Direct
24 Testimony, Dr. Fish used the long-accepted method of synchronizing interest expense
25 within the income tax calculation with rate base. That was the method used in the prior
26 UNS Electric rate case and has been used in rate cases before the Commission since at
27 least 1981. However, in his Surrebuttal, without explanation, Dr. Fish deviated from this

1 accepted practice and used actual interest expense and a proposed operating income
2 adjustment by the Company for his interest expense reduction within his income tax
3 calculation. In doing so, he contradicts the calculation of income taxes he used in his
4 Direct testimony in this case and his calculations in the most recent UNS Gas case. As
5 well, Staff and RUCO witnesses in every case I have participated in the State of Arizona
6 have used the interest synchronization method for calculating income taxes. Both the
7 Company and RUCO have used this methodology in this case. There is simply no
8 rationale for Dr. Fish's mid-case change of methodology.

9
10 **Q. What is the synchronized interest methodology?**

11 A. It is the method of calculating interest cost for income tax calculation purposes that is
12 equivalent to interest component reflected in the cost of capital. This is simply done by
13 taking the pro forma rate base times the weighted average cost of debt in the capital
14 structure. For UNS Electric – Staff's adjusted original cost rate base is \$168,616,324 and
15 the weighted average cost of debt is 3.82%. So the interest expense Staff has proposed
16 recovery of on original cost rate base is \$6,441,144.

17
18 **Q. What is the primary concern with not using the synchronized interest method?**

19 A. The primary concern is that the income tax expense being included in rates will not be in
20 proper synchronization with the return on equity (ROE) included within rates.
21 Essentially, ratemaking income taxes should reflect the effective tax rate applied to the
22 ROE built into revenue requirements – grossed up to insure full recovery of the ROE (in
23 that snap shot of rates in a rate filing). If you apply actual interest expense to the income
24 tax calculation you could over- or under-recover income tax expense.

25
26 For example: if you have \$150 million ("M") in debt in the capital structure and that is
27 40% of your capital at 10% interest rate, its weighted cost is 4%. Thus, if you have a

1 rate base of \$300M, the interest cost associated with financing it is assumed to be \$12M.
2 That is the amount recovered through the return on rate base. Now actual interest cost on
3 the \$150M is \$15M a year, but that is not the amount being recovered through the return
4 on rate base. The reason you would not allow the Company in this example to recover
5 \$15M through a return, or use \$15M in calculating income tax expense, is because a
6 portion of that debt may not have been used to finance assets within rate base. Instead, it
7 may have been used to finance a project under construction (CWIP) or it may have been
8 used to finance some non-regulatory activity. Therefore, you must synchronize the
9 interest recovered with rate base so as to not provide a return of interest cost on capital
10 not used to serve present customers.

11
12 **Q. What is Dr. Fish proposing as interest expense for income tax purposes in his**
13 **Surrebuttal calculation?**

14 A. Dr. Fish is proposing \$7,245,000 in interest expense cost for income tax calculation
15 purposes. He arrived at that amount by taking the actual balance of long term debt by the
16 actual cost of that debt (\$7,050,000) and also added the wholesale credit support cost
17 proposed by the Company in its Rebuttal filing (\$195,500). Attached to my Rejoinder
18 testimony is Exhibit DJD-4, which replicates the workpaper that Dr. Fish provided to
19 support his Surrebuttal income tax calculation. I included a column with my revised
20 calculation using all of Dr. Fish's adjustments except for interest expense for income tax
21 calculation purposes and the income taxes calculated.

22
23 **Q. Should wholesale credit support cost be included within the income tax calculation?**

24 A. No, that cost should not be included. The Company proposed \$195,500 of credit support
25 cost as an operating expense. This is an appropriate expense (if it is not to be recovered
26 through the Company's PPFAC). That is where credit support cost should be reflected
27 (*i.e.*, it should not be reflected in the income tax calculation). If Dr. Fish had accepted this

1 proposed operating income adjustment and included in operating expenses, he would then
2 be essentially deducting them twice which would be improper. That would be equivalent
3 to deducting customer deposit interest expense for tax purposes while it's included as an
4 expense reducing operating income already. But since he did not include the cost within
5 his operating cost, it is simply short term interest expense that is not properly included
6 within the income tax calculation.

7
8 **Q. What is the result of making the correction to the synchronized interest**
9 **methodology?**

10 A. If you correct Dr. Fish's income tax calculation to be reflective of the accepted
11 methodology used in Arizona, then the proposed increase given all his other Surrebuttal
12 positions would be an increase of \$8,197,142 as opposed to \$7,579,110.

13
14 **H. Payroll and Payroll Tax Expense.**

15
16 **Q. Did RUCO discuss its objection to the Company's payroll adjustments in its**
17 **Surrebuttal filing?**

18 A. Dr. Johnson did not provide specific Surrebuttal testimony regarding the Company's
19 2010 payroll adjustment – which he opposed in his Direct testimony. However, Dr.
20 Johnson did readdress his position that the Commission should adhere to a strict
21 historical test year methodology - and that the Commission should generally reject ad hoc
22 adjustments for changes that occurred, or will occur, beyond the end of the test year.
23 This was the primary basis for his position of excluding the 2010 pay rate increase.

1 **Q. Do you have any comments regarding Dr. Johnson's position that the Commission**
2 **should adopt a strict historical test year methodology?**

3 A. Yes. Dr. Johnson's discussions on strict adherence to a historical test year only impacts a
4 portion of two expense adjustments proposed by the Company in this case. Those are:
5 (i) the 2010 pay rate increase applied to the test year level of employees; and (ii) the
6 reduction of property tax expense associated with reduced assessment rates for the 2010
7 property tax payment year. Dr. Johnson accepted the property tax assessment change in
8 his Surrebuttal testimony. These adjustments are known, measureable and based upon
9 rate changes applied specifically to test year levels. While the rate changes are outside of
10 the test year, they are limited to the first year these new rates are anticipated to be in
11 effect. Additionally, these same basic adjustments have been accepted in many recent
12 Commission Decisions including the previous UNS Electric rate case (Decision No.
13 70360).

14
15 **Q. Do you have any other comments regarding Dr. Johnson advocating his strict**
16 **historical test year approach?**

17 A. Yes. Dr. Johnson is making a theoretical argument that these types of adjustments could
18 lead to a mismatch of revenue and cost. That same theoretical argument could be
19 discussed and/or applied to any adjustment to the test year, or even on the test year
20 expense levels themselves. The real question is regarding the specific adjustment being
21 proposed by the Company, the specific test year of the Company and the reasonableness
22 of the request. It is my position that the adjustment proposed to reflect the 2010 pay rate
23 increase applied to the test year ending level of employees to serve test year customers is
24 appropriate and causes no mismatch.

1 **I. Incentive Compensation.**

2
3 **Q. Did Staff address Incentive Compensation in their Surrebuttal?**

4 **A.** Yes. Dr. Fish first addresses a correction to his Direct Testimony position that I proposed
5 in my Rebuttal Testimony, but then describes how (in his view) incentive pay is different
6 than normal payroll expense.

7
8 On the first issue, I am a little perplexed by Dr. Fish's Surrebuttal testimony. The
9 correction itself is not that material. But he implies that the actual test year Performance
10 Enhancement Plan ("PEP") expense provided to him in response to Staff Data Request
11 1.62, is somehow not correct and is superseded by the tax basis number from the FERC
12 Form 1. On the contrary, the note regarding this adjustment on page 2 of Exhibit DJD-2
13 (attached to my Rebuttal testimony) and as also stated on the actual schedule in the FERC
14 Form 1, clearly identifies this as a reconciliation from book net income of \$3.8M to
15 Federal Tax Net Loss of (\$7M). In other words, the amount he uses for PEP expense is
16 not the book expense for PEP, but is the amount reflected in the Federal income tax
17 calculation. That is a different amount.

18
19 On the second, more important issue, Dr. Fish argues that incentive pay is an "extra"
20 reward for above normal productivity, thus making its cost unique and subject to separate
21 treatment. But no party is disputing that PEP is a recurring and normal cost. No party is
22 disputing that it provides benefits to both customers and to shareholders. No party is
23 disputing that it is a cost effective way to reduce the ultimate cost of serving the
24 customers of UNS Electric. And no party is asserting that the combination of the
25 employee base pay and the incentive pay is an unreasonable amount. Indeed, the
26 incentive pay is effectively a hold back from total employee compensation that may then
27 be reallocated.

1 While Dr. Fish's argument continues to come down to it being an "extra" cost that should
2 be born equally by shareholders, the truth is that it is not "extra" cost or above market
3 cost from a companywide perspective. It is a portion of fair compensation that is directed
4 toward high-performing employees and away from non-performing employees. This
5 does not make the company-wide total compensation higher, but could make the
6 compensation of individual employees higher. Higher performing employee's
7 compensation can be higher on an individual year basis. That is the very reason the
8 bargaining unit employees do not want to participate in the program – because a portion
9 of the individuals fair wages would be put at-risk based on individual performance and
10 some will come out ahead and some behind.

11
12 I know in these current economic times incentive compensation is an obvious target for
13 scrutiny. It should never be some guaranteed above market perk. But if it is well
14 designed and based upon placing a portion of fair wages at-risk to allow for rewarding
15 the performers over the non-performers – ultimately providing a net benefit to customers
16 – then it should be included within cost of service at a reasonable and recurring level.
17 My testimony explains and the evidence shows the UNS Electric's PEP is a well-
18 designed program that does provide incentive to employees who directly provide service
19 to UNS Electric's customers.

20
21 **J. SERP.**

22
23 **Q. Did Staff address SERP in their Surrebuttal?**

24 **A.** Yes. Dr. Fish stated that SERP is an incentive program for UniSource officers that should
25 not be recovered from UNS Electric's customers. I disagree with Dr. Fish's assertion that
26 SERP is an incentive program. The SERP program is not an incentive program or any
27 type of bonus program. It is an employee benefit program that is essentially equivalent to

1 the defined benefit pension plan that all qualified employees of UNS Electric participates
2 in. The difference is that you can only have a defined benefit pension plan up to a certain
3 compensation level. In other words, it is capped with regards to making tax deductible
4 contributions for eligible employees. Therefore, for the employees whose compensation
5 exceeds that level, a separate program must be in place so as to insure that those eligible
6 employees receive benefits they would have earned in the defined benefit plan if not for
7 the limitations imposed by the IRS. Thus, it is not an extra benefit or bonus; it is an equal
8 benefit on a proportional basis.

9
10 **Q. Does this conclude your Rejoinder testimony?**

11 **A. Yes.**
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27

EXHIBIT

DJD-3

[illegible]

UNSE ELECTRIC, INC.									
COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT									
TEST YEAR ENDED DECEMBER 31, 2008									
AS OF UNSE REJOINDER TESTIMONY - INCLUDING BLACK MOUNTAIN GENERATING STATION									
	UNSE As Filed 4/30/09	ACC Surrebuttal 1/15/10	RUCO Surrebuttal 1/15/10	UNSE Rebuttal 12/11/09	UNSE Rejoinder 1/25/10				
Original Operating Income - Unadjusted	\$9,786,382	\$9,786,382	\$9,786,382	\$9,786,382	\$9,786,382	Summary			
Operating Income Adjustments									
Operating Revenue Adjustments									
Retail Revenue & Purchased Power Annualization	10,733,456	10,733,456	10,733,456	10,733,456	10,733,456	No dispute			Dukes
Wholesale Rev & Purch Power	(10,168,115)	(10,168,115)	(10,168,115)	(10,168,115)	(10,168,115)	No dispute			Dukes
Weather Normalization	(1,017,300)	(1,017,300)	(1,017,300)	(1,017,300)	(1,017,300)	No dispute			Erdwurm
Customer Energy Annualization & Customer Demand Normalization	(2,820,565)	(2,820,565)	(2,820,565)	(2,820,565)	(2,820,565)	No dispute			Erdwurm
Normalization of Rev & Exp for Fuel and PPFAC	(29,192,263)	(29,192,263)	(29,192,263)	(29,192,263)	(29,192,263)	No dispute			Dukes
CARES Discounts (Staff)	(61,797)	-	(61,797)	(61,797)	(61,797)	Staff disallowed the UNSE operating revenue adjustment for CARES discounts.			Erdwurm
DSM & Renewables Revenue & Expense	(1,458,039)	(1,458,039)	(1,458,039)	(1,458,039)	(1,458,039)	No dispute			Dukes
Total Adjustments to Operating Revenues	(33,984,623)	(33,922,826)	(33,984,623)	(33,984,623)	(33,984,623)				
Operating Expense Adjustments									
Retail Revenue & Purchased Power Annualization	(956,469)	(956,469)	(956,469)	(956,469)	(956,469)	No dispute			Dukes
Wholesale Rev & Purch Power	(10,168,115)	(10,168,115)	(10,168,115)	(10,168,115)	(10,168,115)	No dispute			Dukes
Weather Normalization	(830,613)	(830,613)	(830,613)	(830,613)	(830,613)	No dispute			Erdwurm
Customer Energy Annualization & Customer Demand Normalization	(1,079,814)	(1,079,814)	(1,079,814)	(1,079,814)	(1,079,814)	No dispute			Erdwurm
Normalization of Rev & Exp for Fuel and PPFAC	(19,024,147)	(19,024,147)	(19,024,147)	(19,024,147)	(19,024,147)	No dispute			Dukes
DSM & Renewables Revenue & Expense	(1,626,826)	(1,626,826)	(1,626,826)	(1,626,826)	(1,626,826)	No dispute			Dukes
Payroll Expense (RUCO)	220,252	220,252	79,628	220,252	220,252	RUCO disallowed the increase for the expected 3% wage increase for 2010.			Dukes
Payroll Tax Expense (RUCO)	55,054	55,054	35,430	55,054	55,054	RUCO reduced payroll tax expense related to the disallowed 2010 payroll expense increase.			Dukes
Pension & Benefits (RUCO)	210,866	210,866	210,866	210,866	210,866	RUCO disallowed the increase for expected pension & benefits expense as of January 1, 2009 since it was "anticipated" and thus estimated. Surrebuttal - RUCO agreed with UNSE rebuttal testimony and reinstated the UNSE pro forma as filed in UNSE direct testimony.			Dukes
Post Retirement Medical	161,929	161,929	161,929	161,929	161,929	No dispute			Dukes
Incentive Compensation - PEP Expense (Staff)	-	(132,159)	-	-	-	Staff disallowed 50% of incentive compensation expense in accordance with ACC Decision No. 70390 in the prior UNSE rate case.			Dukes
Payroll Tax - PEP Expense (Staff)	-	(10,110)	-	-	-	Staff reduced payroll tax expense related to the disallowed incentive compensation expense.			Dukes

UNSE ELECTRIC, INC.									
COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT									
TEST YEAR ENDED DECEMBER 31, 2008									
AS OF UNSE REJOINDER TESTIMONY - INCLUDING BLACK MOUNTAIN GENERATING STATION									
	UNSE As Filed 4/30/09	ACC Surrebuttal 1/15/10	RUCO Surrebuttal 1/15/10	UNSE Rebuttal 12/11/09	UNSE Rejoinder 1/25/10				
SERP Expense (Staff)	-	(102,142)	-	-	-	Summary			
						Staff disallowed 100% of SERP expense in accordance with ACC Decision No. 70380 in the prior UNSE rate case.			
Call Center Expense (Staff)	-	(99,476)	-	-	-	Staff disallowed the increase in call center expense over the amount presented in the UNSE prior rate case, citing a decrease in call center call volume. Surrebuttal - Staff corrected their pro forma adjustment as filed in direct testimony based on UNSE rebuttal (correction still includes \$20 error - immaterial & ignored).			
Rate Case Expense (Staff & RUCO)	138,890	72,223	72,223	138,890	138,890	Staff and RUCO disallowed \$200,000 of the \$500,000 proposed test year rate case expense.			
Bad Debt Expense (Staff)	(436,441)	(330,954)	(436,441)	(436,441)	(436,441)	Staff reduced bad debt expense for "inconsistency" in application of the bad debt ratio based on gross revenues that was applied to adjusted revenues. Staff corrected the sign error for bad debt expense as filed in their direct testimony based on UNSE rebuttal.			
Interest on Customer Deposits	(145,701)	(145,701)	(145,701)	(145,701)	(145,701)	No dispute			
Workers Compensation	(115,528)	(115,528)	(115,528)	(115,528)	(115,528)	No dispute			
Miscellaneous Expenses - Other (Staff & RUCO)	(451,888)	(456,651)	(484,460)	(451,888)	(451,888)	Staff reduced industry association dues by 49.93% as approved by the ACC in Decision No. 70380 in the prior rate case, but applied the percentage to total dues per FERC Form 1 and incorrectly did not include amounts for the EEI dues expense that UNSE added to test year expense (in addition to the FERC Form 1 amount). RUCO disallowed 40% of the \$12,800 of the total EEI dues as presented in the original UNSE pro forma adjustment (UNSE added \$11,172 of the EEI dues to the test year). RUCO also reduced the UNSE pro forma for postage expense by disallowing the May 2009 postage increase as being too far outside of the test year. Surrebuttal - Staff corrected industry association dues as filed in their direct testimony based on UNSE rebuttal.			
Miscellaneous Expenses - Outside Legal Expense (Staff & RUCO)	109,434	82,075	76,503	109,434	109,434	Staff reduced outside legal expense to reflect a 3-year average expense based on 2005, 2006 and 2008, citing 2007 expense as non-representative (Staff's calculation had errors in the their pro forma adjustment calculation). RUCO reduced outside legal expense to reflect a 3-year average expense based on 2006, 2007 and 2008. Surrebuttal - Staff corrected outside legal expense as filed in their direct testimony based on UNSE rebuttal.			
Fleet Fuel (Staff)	-	(75,798)	-	(56,333)	(56,333)	Staff reduced test year expense for lower average gasoline & diesel fuel prices based on 2009 fuel price data. UNSE added a pro forma adjustment in rebuttal to reduce test year expense to reflect the average fuel cost based on data from 2007 through October 2009.			
Wholesale Credit Support	-	-	-	195,500	195,500	UNSE added a pro forma adjustment in rebuttal to increase test year expense for wholesale credit support.			
A&G Expense Capitalized	(229,429)	(229,429)	(229,429)	(229,429)	(229,429)	No dispute			
Depr & Property Tax for Post TY Non-Rev. Plant in Service (Staff & RUCO)	442,526	-	-	442,526	442,526	Staff and RUCO disallowed Post-Test Year Non-Revenue Plant in Service.			
Depr & Amort Expense Annualization	(507,792)	(507,792)	(507,792)	(507,792)	(507,792)	No dispute			
Property Tax Expense (RUCO)	(7,358)	(7,358)	(7,358)	105,181	105,181	RUCO adjusted the property tax assessment ratio from 21% to 22%. In rebuttal, UNSE revised property tax expense to reflect property tax rates for 2009 (a revision from the original adjustment based on property tax rates for 2008). Surrebuttal - RUCO agreed with UNSE rebuttal testimony and revised their pro forma to match UNSE as filed in direct testimony.			

Witness
Dukes
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Grant
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Kissinger
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Kissinger

UNSE ELECTRIC, INC.									
COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT									
TEST YEAR ENDED DECEMBER 31, 2008									
AS OF UNSE REJOINDER TESTIMONY - INCLUDING BLACK MOUNTAIN GENERATING STATION									
	UNSE As Filed 4/30/09	ACC Surrebuttal 1/15/10	RUCO Surrebuttal 1/15/10	UNSE Rebuttal 12/11/09	UNSE Rejoinder 1/25/10	Witness			
Income Taxes (Staff & RUCO)	39,582	88,329	39,582	(55,652)	(55,652)	Changes are recalculations based on other pro forma adjustments. Staff's calculation of revised income tax expense used the incorrect tax rate and excluded the impact of cash working capital and synchronized interest.	Kissinger		
BMGS PPA Adjustment (Staff)	(10,960,779)	-	(10,960,779)	(10,960,779)	(10,960,779)	Staff disallowed all BMGS pro formas. RUCO allowed all of BMGS in the revenue requirement.	Dukes		
BMGS O&M Expense (Staff)	1,158,464	-	1,158,464	1,158,464	1,158,464	Staff disallowed all BMGS pro formas. RUCO allowed all of BMGS in the revenue requirement.	Dukes		
BMGS Depr & Amort Expense Annualization (Staff)	1,649,496	-	1,649,496	1,649,496	1,649,496	Staff disallowed all BMGS pro formas. RUCO allowed all of BMGS in the revenue requirement.	Kissinger		
BMGS Property Tax Expense (Staff & RUCO)	419,305	-	420,211	419,305	434,148	Staff disallowed all BMGS pro formas. RUCO allowed all of BMGS in the revenue requirement. In rejoinder, UNSE revised BMGS property tax expense for a revision in the assessment ratio that was omitted from rebuttal. Surrebuttal - RUCO agreed with UNSE rebuttal testimony and revised their pro forma to match UNSE rebuttal for the base case, but not for BMGS due to timing.	Kissinger		
BMGS Income Taxes (Staff)	2,079,821	-	2,079,821	2,079,821	2,074,196	Staff disallowed all BMGS pro formas. RUCO allowed all of BMGS in the revenue requirement.	Kissinger		
Synchronize Income Taxes (RUCO)	-	-	93,130	-	-	RUCO adjusted synchronized interest related to interest on debt as a separate expense instead of including it in the income tax expense adjustment.	N/A		
Total Adjustments to Operating Expense	(39,855,281)	(35,008,354)	(40,496,189)	(39,698,809)	(39,689,591)				
Total Net Adjustments	5,870,658	1,085,528	6,511,566	5,714,186	5,704,968				
Adjusted Operating Income	\$15,657,039	\$10,871,910	\$16,297,948	\$15,500,568	\$15,491,350				
Operating Income Deficiency	\$5,786,841	\$3,291,861	\$2,235,648	\$5,931,342	\$5,939,921				
Fair Value Addition (Pre-Tax)	\$2,463,680	\$1,339,997	\$579,160	\$2,318,979	\$2,310,400	Assuming acceptance of the Company's pro forma adjustments and fair value rate base - the Company has limited the fair value addition so as to not exceed the requested increase noticed to customers.	Grant		
Fair Value Operating Income Deficiency	\$8,250,321	\$4,631,859	\$2,814,808	\$6,250,321	\$8,250,321				
Gross Revenue Conversion Factor	1.6363	1.6363	1.6363	1.6363	1.6363		Kissinger		
Increase in Gross Revenue Requirement	\$13,500,000	\$7,579,110	\$4,805,871	\$13,500,000	\$13,500,000				

EXHIBIT

DJD-4

UNS ELECTRIC, INC.

TEST YEAR ENDED DECEMBER 31, 2008

ACC STAFF SYNCHRONIZED INTEREST & INCOME TAX CALCULATION
REVENUE REQUIREMENT COMPARISON

	UNSE Revision of Staff's Calculations	Staff Surrebuttal Revised per Dr. Fish
Staff Weighted Average cost of Capital	8.40%	8.40%
Staff Required Operating Income (Proposed Return on OCRB)	\$14,163,717	\$14,163,717
Staff Fair Value Adj. to Required Operating Income (Proposed FV Return on OCRB)	\$1,339,997	\$1,339,997
Staff Total Required Operating Income (Proposed Total Return on OCRB)	\$15,503,714	\$15,503,714
UNSE Proposed Operating Expenses Before Income Taxes	(\$146,801,451)	(\$146,801,451)
Staff Proposed Operating Expenses Before Income Taxes	(\$147,945,938)	(\$147,945,938)
Staff Pro Forma Operating Income Before Income Taxes	\$13,041,924	\$13,041,924
Less Synchronized Interest per UNSE review *	(\$6,441,144)	
Less Actual Interest on Long-Term Debt **		(\$7,050,000)
Less Actual Interest - Credit Support Costs ***		(\$195,000)
Pro Forma Taxable Income	\$6,600,780	\$5,796,924
Tax Rate	38.5980%	38.5980%
Income Tax Expense	\$2,547,769	\$2,237,497
Pro Forma Operating Income After Income Taxes	\$10,494,155	\$10,804,427
Operating Revenue Revenue Shortfall	\$3,669,562	\$3,359,290
Operating Revenue - Fair Value Increment	\$1,339,997	\$1,339,997
Operating Revenue Deficiency	\$5,009,559	\$4,699,287
Gross Revenue Conversion Factor	1.6363	1.6363
Staff Corrected Revenue Requirement Increase	\$8,197,142	\$7,689,443
Staff Surrebuttal Revenue Requirement Increase as Filed		\$7,579,110
Change in Staff Revenue Requirement Increase		\$110,333

* OCRB x weighted average cost of debt of 3.82%

** Long-Term Debt x Cost of Debt of 7.05%

*** Actual annual cost as per Grant rebuttal testimony

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF)	DOCKET NO. E-04204A-09-0206
UNS ELECTRIC, INC. FOR THE)	
ESTABLISHMENT OF JUST AND)	
REASONABLE RATES AND CHARGES)	
DESIGNED TO REALIZE A REASONABLE)	
RATE OF RETURN ON THE FAIR VALUE OF)	
THE PROPERTIES OF UNS ELECTRIC, INC.)	
DEVOTED TO ITS OPERATIONS)	
THROUGHOUT THE STATE OF ARIZONA.)	
)	
)	

Rejoinder Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Electric, Inc.

January 25, 2010

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I.	Residential Rate Design.....	1
II.	Low Income Program Expansion	8
III.	CARES – Adjustment to Operating Income.....	9

Exhibits:

Exhibit DBE-6	Potential Margin Loss Under Various Rate Designs
Exhibit DBE-7	Calculation of CARES Discount Adjustment

1 **Q. Please state your name and business address.**

2 A. My name is D. Bentley Erdwurm. My business address is One South Church Avenue,
3 Tucson, Arizona 85701.

4
5 **Q. Are you the same D. Bentley Erdwurm who filed Direct and Rebuttal testimony in**
6 **this case?**

7 A. Yes.

8
9 **Q. What is the Purpose of your Rejoinder testimony?**

10 A. The purpose of my Rejoinder testimony is to respond to Dr. Ben Johnson's (RUCO)
11 Surrebuttal testimony on residential rate design, including the customer charge and
12 tiered rates. Additionally, I address Dr. Thomas H. Fish's and Mr. William C. Stewart's
13 Surrebuttal testimony on the expansion of the CARES program. Finally, I address Dr.
14 Fish's position regarding a \$61,797 adjustment to operating income related to the
15 CARES program.

16
17 **I. RESIDENTIAL RATE DESIGN.**

18
19 **Q. Please summarize UNS Electric's proposed residential rate design and RUCO's**
20 **proposed design, as supported by RUCO witness Dr. Ben Johnson.**

21 A. The current residential customer charge is \$7.50 per month. UNS Electric has proposed
22 a residential customer charge of \$8.00 per month. Staff supports UNS Electric's
23 residential customer charge proposal. However, RUCO continues to propose reducing
24 this charge to \$5.00 per month.

25
26 The current residential rate has an inclining block structure, with two rate blocks. UNS
27 Electric proposes to continue the current two block structure and Staff has agreed with

1 that proposal. However, RUCO has proposed a three block design. Under an inclining
2 block rate structure, the price of incremental usage rises as usage rises.

3
4 **Q. Dr. Johnson claims on pages 8 to 9 of his Surrebuttal testimony that the Company's**
5 **residential rate design proposal is "based on an embedded cost allocation approach**
6 **which allocates substantial portions of the Company's distribution investment and**
7 **operating expenses on the basis of customers, regardless of whether or not these**
8 **items directly vary in response to decisions by customers to join or leave the**
9 **system." Please comment.**

10 A. I disagree. Costs classified by UNS Electric as "customer-related" and recovered
11 through the customer charge are limited to metering, meter-reading, billing and
12 customer service, and customer-specific equipment at the customer's premises. These
13 costs vary with changes in the number of customers, not with kWh sales. UNS Electric
14 has not used any technique that classifies a portion of the upstream distribution system
15 (upstream of the customer) on a customer-related basis.

16
17 **Q. Dr. Johnson states on page 9 of his Surrebuttal Testimony that the customer charge**
18 **primarily should collect the variable costs of metering, billing and collecting the**
19 **monthly bill. Do you agree that only variable costs should be included?**

20 A. No. Both fixed and variable costs of customer related costs - metering, meter-reading,
21 billing and customer service, and customer-specific equipment at the customer's
22 premises - should be included in the customer charge. For clarity, consider the costs of
23 billing a customer. Some of these costs are variable (for example, the postage to send
24 the bill and the paper stock on which the bill is printed). Some of the costs are fixed
25 (for example the salaries of the Company employees engaged in the billing function and
26 the cost of the computer billing software). UNS Electric must incur both fixed and
27

1 variable costs to bill customers, and both are appropriately included in the customer
2 charge calculation.

3
4 UNS Electric's proposed customer charges in this case and in previous cases have been
5 supported by average embedded cost analyses that include both fixed and variable costs.
6 In fact, the Commission has approved such analyses as the basis for customer charges
7 (including for Arizona Public Service Company (APS) and Tucson Electric Power
8 Company (TEP)) over the last 20 years. Dr. Johnson's methodology is inconsistent
9 with methodologies previously used to derive customer charges for Arizona utilities.
10 Moreover, Dr. Johnson has not demonstrated why a volumetric recovery of fixed costs
11 would be preferable to a customer-based recovery. Dr. Johnson has provided an
12 example that a store's parking lot is not recovered on a "per-customer" basis, but
13 instead on the basis of customers' purchase volumes. Retail stores like COSTCO,
14 however, impose a per-customer membership fee. Even so, it is questionable how
15 much relevance an unregulated grocery store parking lot has to the recovery of the cost
16 of providing regulated electric service to customers.

17
18 **Q. Limiting our focus to utility pricing in a regulated environment, can you identify**
19 **another justification for inclusion of both fixed and variable customer-related costs**
20 **in the customer charge?**

21 **A.** Yes. Dr. Johnson's approach of including only variable costs in the customer charge is
22 anti-competitive under the direct access rules that are still "on the books" in Arizona.
23 Under direct access, billing, metering and meter-reading are competitive services that
24 may be provided by third parties. If a utility sets its billing component at just the
25 variable costs of billing, a third party supplier who aims to "meet or beat" the utility's
26 billing component will be unable to fund its billing infrastructure. The variable cost-
27 based billing component provides just enough for the postage and the paper stock, but

1 nothing for the employees or for software and equipment in the billing function. No
2 viable third party competition could develop. While there is currently no residential
3 direct access in Arizona, the Commission should still recognize that acceptance of a
4 "variable cost only" customer charge is inconsistent with parts of Arizona's current
5 regulatory framework.

6
7 **Q. Do you find any inconsistencies in Dr. Johnson's support of forward-looking,**
8 **marginal cost principles?**

9 A. Yes. Dr. Johnson supports a forward-looking, marginal approach to rate design that
10 may or may not recover the utility's approved margin; however, he then advocates for a
11 strict historical test year approach with little, if any, adjustments to rate base, revenues
12 and expenses (even those that are known and measureable). This inconsistency is
13 problematic even without addressing the appropriateness of his marginal cost approach
14 of rate design.

15
16 **Q. Is the utility industry moving toward lower customer charges and higher energy**
17 **charges?**

18 A. No. There is no consistent movement in this direction across all jurisdictions. Though
19 such a rate design may promote conservation, some jurisdictions such as Indiana, Ohio,
20 and others are gradually increasing the level of the customer charges in order to recover
21 more of the customer-related (non-volumetric) costs in the fixed rate component. In
22 fact, Ohio has even approved a customer charge (reservation charge) designed in a
23 manner commonly used by the FERC called a "straight fixed variable rate design",
24 which places most of the system's fixed costs in the customer charge (reservation
25 charge) and collects only variable costs in the volumetric charge. This demonstrates
26 that some jurisdictions are moving in an opposite direction of what Dr. Johnson is
27 proposing here.

1 **Q. Do you still believe Dr. Johnson's proposed rate design radically shifts cost recovery**
2 **away from the customer charge to the energy charge?**

3 A. Yes. Dr. Johnson's proposal deviates from past regulatory practice in two very
4 significant ways. First, Dr. Johnson is proposing to reduce the residential customer
5 charge, when customer charges have been consistently increasing over time for other
6 major Arizona electric companies, including TEP APS, and Salt River Project (SRP).
7 Dr. Johnson's abandonment of past trends is perplexing because (i) UNS Electric's
8 proposed \$8.00 residential customer charge is in-line with similar charges at other
9 Arizona companies, and (ii) the increasing trend is fully supported by accepted costing
10 methodologies. By contrast, Dr. Johnson's \$5.00 customer charge for UNS Electric
11 would make the UNS Electric charge an outlier - lower than comparable customer
12 charges for TEP, APS and SRP.

13
14 Second, Dr. Johnson uses a marginal cost approach while the Company uses the
15 average embedded approach. As I stated earlier, UNS Electric, TEP, and APS
16 residential customer charge proposals over the last twenty years have been supported by
17 an average embedded cost study. Dr. Johnson offered no evidence that the Company's
18 average embedded cost method is invalid, and cannot since it is an accepted method of
19 cost allocation in Arizona.

20
21 **Q. Why does Dr. Johnson's residential rate design proposal put UNS Electric's cost**
22 **recovery at risk?**

23 A. Under both the UNS Electric residential rate design proposal and Dr. Johnson's
24 proposal, a reduction in sales will lead to margin loss. However, Dr. Johnson's
25 approach leads to greater margin loss than UNS Electric's approach. Dr. Johnson's
26 third residential rate tier assumes cost recovery on kWh sales in excess of 800 kWh per
27 month. Because of conservation efforts, sales in this third tier (the highest priced tier)

1 will likely decline more than lower tier sales. Consequently, sales revenue from the
2 third tier will be reduced. As conservation eats away at third tier usage, the Company's
3 ability to recover its revenue requirement and its opportunity to earn a reasonable rate of
4 return diminish.

5
6 Dr. Johnson claims on pages 12 to 13 of his Surrebuttal testimony that the potential
7 impact of his residential rate design on UNS Electric's revenue and net income is
8 "relatively mild." Exhibit DBE-6, however, shows that the margin loss would be over
9 20% higher – under both a 2% and 5% kWh sales reduction scenario – under Dr.
10 Johnson's rate design. RUCO's rate design will likely increase margin loss by
11 \$102,180 and \$255,449 under the 2% and 5% sales reduction scenarios respectively –
12 based on a 12-month period. Even so, this margin loss will compound over time.
13 Under the 2% sales reduction scenario, the second year loss would be 4% (from the date
14 of rate inception; i.e., 2 years of 2% losses) and the third year loss would be 6% (from
15 the date of rate inception; i.e., 3 years of 2% losses). So, the total compounded loss will
16 be six times the annual total of \$102,180 – or over \$600,000. This is a significant
17 impact to the Company.

18
19 Exhibit DBE-6 further shows that kWh sales reductions of just 2% to 5% will
20 substantially reduce the net income of UNS Electric under *both* the UNS Electric and
21 RUCO rate design proposals. As indicated, 2% reductions in sales reduce net income
22 by around \$500,000 (\$445,404 under UNS Electric, \$547,584 under RUCO) and 5%
23 reductions in sales reduce net income by around \$1,250,000 (\$1,113,510 under UNS
24 Electric, \$1,368,959 under RUCO). Still, Dr. Johnson proposes to put any revenue
25 stability in greater jeopardy by proposing a decrease in customer charge.
26
27

1 Given UNS Electric's exposure to the risk of cost under-recovery under either rate
2 design proposal, TEP believes that RUCO should work toward finding win-win
3 solutions that will lessen rather than increase recovery risks. Even without the rate
4 design change sponsored by Dr. Johnson, UNS Electric is faced with a dilemma: The
5 Commission is contemplating energy efficiency objectives that may necessitate sales
6 reductions of around 2% per year over the coming decade. A utility cannot fully
7 recover its costs if rates are designed in a manner that redistributes the recovery of fixed
8 costs from a fixed customer charge to a volumetric rate – especially when sales volumes
9 start disappearing by design or by public policy.

10
11 **Q. Has Dr. Johnson proposed any solutions to help align the goals of conservation with**
12 **the Company's ability to earn a fair rate of return?**

13 A. No. Dr. Johnson does not acknowledge that a problem exists. UNS Electric does not
14 seek "guarantees" of earnings, just a reasonable opportunity to earn a fair return. The
15 Company, however, needs a rate structure that recognizes it is a provider of electric
16 service, and not simply a seller of a commodity.

17
18 Any Commission approved rate structure should align important policy goals (e.g.,
19 conservation and efficiency) with a financially-healthy public service corporation.
20 Avoiding artificially low customer charges – and implementing customer charges that
21 more fully recover costs – is consistent with that new business model. The Commission
22 should make the correct level of fixed cost recovery (revenue collected to recover fixed
23 costs) more independent of sales being at a certain level. Dr. Johnson's proposal does
24 the opposite.

1 **II. LOW-INCOME PROGRAM EXPANSION.**

2
3 **Q. Staff witness Mr. William C. Stewart alleges that UNS Electric has changed its**
4 **position on Low-Income program expansion in Rebuttal testimony. What is your**
5 **response?**

6 A. In Direct testimony, UNS Electric indicated that it supported expansion of the Low-
7 Income programs from 150% to 200% of poverty. UNS Electric believed that there was
8 consensus among stakeholders to expand the program. However, RUCO does not
9 support this expansion. In light of RUCO's position, UNS Electric is not taking a
10 position at this time on the expansion of the low-income programs. Additionally, UNS
11 Electric is not opposed to some minor changes in the structure of the CARES program,
12 provided the Company can recover associated revenue shortfalls. UNS Electric has
13 always expressed the position that its support of any program is conditioned on full
14 recovery of any revenue shortfall from other system customers.

15
16 **Q. Does the Company remain opposed to Staff's proposed changes to the manner in**
17 **which the PPFAC is currently applied to low income customers?**

18 A. Yes. UNS Electric continues to oppose Staff's position that low-income customers be
19 subject only to PPFAC decreases, but not increases. UNS Electric's position is for
20 CARES customers to pay a reduced base power supply rate, and to freeze the PPFAC
21 forward and true-up components at zero upon implementation of new rates. UNS
22 Electric's proposal to reduce the base power supply is in addition to other discounts it
23 has proposed for CARES customers. Staff's proposal could result in significantly
24 increased PPFAC charges to non-low income customers, depending on changes in the
25 wholesale electric rates, although Staff has not addressed this potential impact.

1 **III. CARES –ADJUSTMENT TO OPERATING INCOME.**

2
3 **Q. On page 16 of his rebuttal testimony Dr. Fish again recommends the disallowance of**
4 **the \$61,797 adjustment you indicated was necessary to adjust operating income to**
5 **reflect the discount Customer Assistance Residential Energy Support (“CARES”)**
6 **customers receive. Will you explain why this adjustment is appropriate and should**
7 **be approved?**

8 **A.** Yes. Dr. Fish indicated he would like to see support for the adjustment. I will explain
9 the adjustment in more detail and provide supporting documentation in my attached
10 Exhibit DBE-7. I note that the Company provided Dr. Fish this information in
11 workpapers. This information with my added explanation should clarify our need for
12 the adjustment and why it is appropriate.

13
14 **Q. Does UNS Electric currently have a separate pricing plan for CARES customers**
15 **that differs from the regular Residential customer’s pricing plan?**

16 **A.** No. The current tariff is the same for a similarly situated Residential customer
17 regardless of whether he/she is a CARES customer or not. The CARES customers
18 currently receive a discount through a “Rider”. This discount is applied to the CARES
19 bill after the monthly consumption and resulting billing components have been
20 determined, and is based on three tiers of discounts that are capped at \$8.00 per
21 customer if monthly consumption exceeds 1,000 kwh (2,000 kwh if the customer is on
22 the Medical Life Support Program).

1 **Q. When the Company generates its revenue proof (based on current rates), in order to**
2 **determine if the billing determinants used in the case achieve the test year revenues,**
3 **is a separate CARES calculation identified?**

4 **A.** Yes, but the rates for the class are the same as for a regular Residential Customer and
5 are priced out as such.
6

7 **Q. How is the CARES discount factored into the calculation?**

8 **A.** Since there are multiple tiers, the Company had to extract individual discount data from
9 each customer during the test year and then accumulate it for a single line item
10 adjustment to the CARES-related sales on the Revenue Proof. As can be seen on line
11 15 of Exhibit DBE-7, Page 1 of 1, the total CARES related discount totaled \$690,468.
12

13 **Q. Does this adjustment reflect all of the necessary reductions to the Operating**
14 **Revenues relating to the CARES Program?**

15 **A.** No. The \$690,468 adjustment does not account for customer annualization or weather
16 normalization. Adjustments to sales were 6,427,785 kWh and -701,841 kWh for
17 customer annualization and weather normalization, respectively. The net of these two
18 adjustments totals 5,725,944 kWh approximately 8.95% of the test year sales of
19 63,995,155 kWh for the CARES group of residential customers (see line 16 of Exhibit
20 DBE-7).
21

22 Since the only dollar adjustment to test year CARES usage was based on actual test
23 year discounts, an additional adjustment of \$61,797 had to be made to reflect the
24 discount amounts associated with the adjusted (for customers and weather) sales.
25
26
27

1 **Q. How did you calculate this adjustment?**

2 **A.** Since the CARES discounts fall into multiple tiers the Company took the test year
3 discount amount of \$690,468 and adjusted it by the adjusted increase in sales of 8.95%.
4 The resulting adjustment to Operating Income is \$61,797 (the product of \$690,468
5 times 8.95%). This is shown on line 18 of Exhibit DBE-7.

6
7 **Q. Does this adjustment in any way result in an understatement of Company's**
8 **Operating Revenues or reflect a "double counting" of the discount amounts as**
9 **indicated by Dr. Fish?**

10 **A.** No. This adjustment reflects the dollar discount that will be offered to all CARES
11 customers contributing to the net normalized and annualized increase in sales calculated
12 for this group of customers. This increased sales amount has not been contested and is
13 a reasonable adjustment. UNS Electric will lose revenues based on any increase in sales
14 to this group of customers per the CARES provisions in the tariffs. The Company has
15 calculated this loss of revenues to be \$61,797. Unless it is excluded from Operating
16 Income, UNS Electric will be required to absorb the cost of these discounted rates. That
17 is not acceptable to the Company.

18
19 **Q. Does this conclude your Rejoinder testimony?**

20 **A.** Yes.
21
22
23
24
25
26
27

EXHIBIT

DBE-6

UNS Electric, Inc.
Potential Margin Loss Under Various Rate Designs

UNSE Proposed
Higher Customer Charge - Two Tiers

***** 2% Reduction *****

	Rate	Billing Determinates	Revenue
1	Cust Chg \$8.00	847,229	\$6,777,836
2	Block 1 \$ 0.020070	344,547,535	\$6,915,069
3	Block 2 \$ 0.030084	395,719,694	\$11,904,831
4	Block 3 N/A	N/A	N/A
5	Base Power \$ 0.074812	740,267,229	\$55,380,872
6			<u>\$80,978,608</u>

***** 5% Reduction *****

	Billing Determinates	Revenue	Revenue Change
	847,229	\$ 6,777,836	\$ -
	344,547,535	\$ 6,915,069	\$ -
	395,719,694	\$ 10,791,321	\$ (113,510)
	703,253,968	\$ 52,611,828	\$ (2,769,044)
		<u>\$77,096,054</u>	<u>(\$3,882,554)</u>

Margin Loss Under UNSE Design
\$ 445,404

Margin Loss Under UNSE Design
\$ 1,113,510

7

RUCO-Type Design
Lower Customer Charge - Three Tiers

***** 2% Reduction *****

	Rate	Billing Determinates	Revenue
8	Cust Chg \$5.00	847,229	\$4,236,147
9	Block 1 \$ 0.021985	344,547,535	\$7,574,878
10	Block 2 \$ 0.031986	282,782,081	\$9,044,937
11	Block 3 \$ 0.041986	112,937,613	\$4,741,747
12	Base Power \$ 0.074812	740,267,229	\$55,380,872
13			<u>\$80,978,580</u>

***** 5% Reduction *****

	Billing Determinates	Revenue	Revenue Change
	847,229	\$ 4,236,147	\$ -
	344,547,535	\$ 7,574,878	\$ -
	282,782,081	\$ 8,462,991	\$ (591,946)
	94,430,333	\$ 3,964,734	\$ (777,003)
	703,253,968	\$ 52,611,828	\$ (2,769,044)
		<u>\$ 76,840,578</u>	<u>(\$4,133,003)</u>

Margin Loss Under RUCO Design
\$ 547,584

Margin Loss Under RUCO Design
\$ 1,368,959

14

Additional Margin Loss
Under RUCO Design
\$ 102,180

Line 14 - Line 7

Additional Margin Loss
Under RUCO Design
\$ 255,449

Line 14 - Line 7

15

EXHIBIT

DBE-7

UNS Electric, Inc.

**CARES DISCOUNT TEST YEAR ACTIVITY
FOR PERIOD ENDING DECEMBER 31, 2008**

	Cares Discount	Cares Medical Discount	Total
1 January	\$48,425.36	\$2,840.43	
2 February	\$46,463.15	\$2,868.59	
3 March	\$45,407.37	\$2,665.48	
4 April	\$48,756.25	\$2,934.19	
5 May	\$46,549.55	\$2,923.69	
6 June	\$38,169.29	\$2,270.79	
7 Subtotal	\$273,770.97	\$16,503.17	\$290,274.14
8 July	\$61,555.95	\$3,891.48	
9 August	\$58,511.19	\$4,038.00	
10 September	\$60,862.97	\$4,116.13	
11 October	\$68,060.49	\$4,870.99	
12 November	\$59,031.54	\$6,106.80	
13 December	\$64,452.47	\$4,695.35	
14 Subtotal	\$372,474.61	\$27,718.75	\$400,193.36
15 TOTAL	\$646,245.58	\$44,221.92	\$690,467.50

	Test Year Unadjusted Sales	Cares Customer Annualization Sales Adjustment	Weather Normalization Adjustment	Adjustment as a Percent of total TY sales
16	63,995,155	6,427,785	(701,841)	8.95%
17	Test Year Cares Discount Adjustment to Retail Revenues			\$752,264.00
18	Cares Discount Adjustment			\$61,796.50